No. 85-1796

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

ROBERT C. HICKERSON, on his own behalf and on behalf of all others similarly situated,

Petitioner,

v.

VELSICOL CHEMICAL CORPORATION, a Delaware corporation; **THE NORTHERN TRUST COMPANY**, an Illinois banking corporation, as Trustee of the Velsicol Chemical Corporation Pension Plan; **BEN W. HEINEMAN**; **PAUL J. WEIR**; **BERNARD FIRESTONE**; **ROBERT R. GARRISON**; and **THE RETIREMENT COMMITTEE OF THE VELSICOL CHEMICAL CORPORATION PENSION PLAN**,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

I.

Does it violate ERISA to "convert" a profit sharing plan into a pension plan with the provision that all earnings in excess of 5% earned on the participants' fully-vested monies be used to pay the employer's pension contribution obligation?

II.

Did ERISA narrow the scope of protection afforded profit sharing plan participants so as to make conduct legal which would have been illegal under the common law of trusts with respect to the disposition of earnings on participants' monies?

III.

Did the Seventh Circuit err in creating a "reasonableness" exception to ERISA's "Prohibited Transactions" section?

IV.

Did the Seventh Circuit incorrectly conclude that participants in profit sharing plans do not have an "ownership interest" in their 100%-vested profit sharing plan account balances?

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioner, Robert C. Hickerson, on his own behalf and on behalf of all others similarly situated ("the Class"), respectfully requests that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Seventh Circuit entered on December 3, 1985.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 778 F.2d 365 and appears in the Appendix hereto at 1a. The opinion of the United States District Court for the Northern District of Illinois is not reported; it appears in the Appendix at 29a.

JURISDICTION

The judgment of the Court of Appeals was entered on December 3, 1985. The Court of Appeals denied the Class's petition for rehearing on January 29, 1986. The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. §1254(1).

STATUTES INVOLVED

Three sections of the Employee Retirement Income Security Act ("ERISA") are involved in this case. The first is Section 404(a)(1)(A) of ERISA, 29 U.S.C. §1104(a)(1)(A). The second is Section 406(a)(1)(D) of ERISA, 29 U.S.C. §1106(a)(1)(D). The third is Section 404(a)(1)(D) of ERISA, 29 U.S.C. §1104(a)(1)(D). These provisions are set forth in full in the Appendix hereto at, respectively, 45a, and 46a.

STATEMENT OF THE CASE

Creation And Funding Of The Profit Sharing Trust Fund

In 1956, the Velsicol Deferred Profit Sharing Plan ("the Profit Sharing Plan") was put into effect. Each year following the establishment of the Profit Sharing Plan—for 19 consecutive years—Velsicol was profitable and made contributions to the Profit Sharing Plan. In the seven years immediately preceding the April, 1975 "conversion" of the Profit Sharing Plan discussed below, Velsicol's payments to the Profit Sharing Trust Fund averaged some $409,334 per year, and during the last five years had increased almost geometrically, culminating in Velsicol's record 1974 contribution of $1,065,970:

Profit Sharing Contributions

1968	$ 328,454
1969	227,202
1970	149,751
1971	259,599
1972	333,430
1973	500,934
1974	1,065,970

The Corpus In Question

At the time that the Profit Sharing Plan was converted, the balance in the Profit Sharing Trust Fund was $4,400,154. As of March 31, 1975, that entire balance was fully-vested in the Profit Sharing Plan Participants. It is those Profit Sharing Plan Participants who constitute the Class in this case. It is that $4.4 million corpus as of March 31, 1975—and more particularly, income earned on it subsequently—that is the subject of this lawsuit.

The Differing Membership Between The Profit Sharing Plan Participants And The Pension Plan Participants

On April 1, 1975, the Profit Sharing Plan was "converted"* into and replaced by the Velsicol Pension Plan. On the first day of the existence of the Pension Plan (*i.e.*, April 1, 1975), the membership in the Pension Plan was identical to the membership in the Profit Sharing Plan; that is, employees went to bed on March 31 fully-vested participants of the Profit Sharing Plan and woke up April 1 participants in the Pension Plan.** It is those 563 participants in the Profit Sharing Plan as of March 31, 1975 who constitute the Class in the case at bar.

After April 1, 1975, however, the membership in the two plans changed as *new* Velsicol employees became participants in the Pension Plan and former employees left. By January 1, 1977, for instance, there were 759 participants in the Pension Plan. Hence, by that time, because of retirements, deaths, separations and new hirings, there were substantially in excess of 200 (and probably closer to 250) new employees covered by the Pension Plan who had not been participants in the Profit Sharing Plan. Hereafter the term "Class Member Participants" will refer to the 563 Pension Plan participants who were formerly members of the Profit Sharing Plan (*i.e.*, the class that was certified by the district court). The phrase "Non-Class Member Participants" will refer to those *new* employees hired after April 1, 1975 who became par-

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* Whether the Profit Sharing Plan was "terminated," "amended," "converted" or "replaced" is a matter of dispute between the parties. While the parties disagree as to the legal significance of events, however, there is no dispute as to the events that transpired.

** The Pension Plan refers to these persons as "Participants In Former Plan." Velsicol Pension Plan, par. 3.01.

ticipants in the Pension Plan (and who are not members of the Class). By the time judgment was entered in this case, Class Member Participants constituted only 20% of the membership in the Pension Plan.

The Impact Of The Use Of Profit Sharing Earnings On Velsicol's Obligations Under The Pension Plan

When Velsicol created the new Pension Plan, it provided that Velsicol would "guarantee" the Class Member Participants 5% per annum on their Profit Sharing account balances. As is discussed below, it was anticipated that the $4.4 million corpus would earn substantially in excess of 5%, but Velsicol provided that all earnings made on the Profit Sharing monies would stay in the Pension Plan. The effect of using the "excess" earnings on the Profit Sharing corpus is demonstrated by comparing the returns realized on the Profit Sharing Trust corpus for the period subsequent to April 1, 1975 for which final figures are available with Velsicol's contributions to the Pension Plan during that same period. According to defendants, the earnings on the Pension Fund (which included the $4.4 million from the Profit Sharing Trust corpus) had returns as follows:

	Trust Income (Or Loss)
1975	+25.0%
1976	+ 7.0%
1977	(55/100 of 1%)
1978	+ 9.4%
1979	+13.7%
1980	+19.6%
1981	+ 6.7%
1982	+28.1%

Hence, the average return received on the Profit Sharing Trust corpus subsequent to the "conversion" was 13.62% per year.*

Velsicol's contributions to the Pension Plan during this same period were as follows:

	Velsicol's Pension Plan Contributions
1975	$490,595
1976	452,149
1977	302,370
1978	403,393
1979	531,608
1980	-0-
1981	-0-
1982	-0-

Hence, during the eight-year period subsequent to the conversion for which final figures are available, it is seen that Velsicol's average contribution to the Pension Plan was $272,514. That is to be contrasted with an average annual contribution to the Profit Sharing Plan of $409,334 during the seven years prior to the conversion. When the post-conversion contribution figures are adjusted for inflation into "1974 dollars" (*i.e.*, the last year a contribution was made to the Profit Sharing Trust Fund), Velsicol's average Pension Plan contribution was $222,181 per year compared to its $409,334 average contribution under the Profit Sharing Plan discussed above.

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* At the time the district court's liability ruling (Appendix, p. 29a) was made, information concerning the 1982 investment returns and Velsicol's contributions were not before the court. By the time the damage order was entered, this information was before the court. That is why the numbers in the district court opinion appended hereto do not include the 1982 information.

It is to be noted, incidentally, that this average Pension Plan contribution of $272,000 (adjusted for inflation to $222,000) is the *total* contribution by Velsicol on behalf of *both* the 563 Class Member Participants in the Pension Plan *and* the 200-250 Non-Class Member Participants.

Similarly, Velsicol's contributions expressed as a percentage of employee salaries dropped dramatically as a result of the conversion. According to defendants' calculations during the 19 years the Profit Sharing Plan was in effect, Velsicol's contributions averaged 8.3% of the Class Member Participants' total salaries. Since the conversion, however, the Velsicol contributions-as-a-percentage-of-salaries has dropped to less than 2.45%.

Defendants' Expectation With Respect To Earnings On Fund Monies

As indicated above, the foregoing results (*i.e.*, investment results on the Profit Sharing monies substantially in excess of 5% with the corresponding reduction in Velsicol's pension funding obligations) were not unexpected; to the contrary, they were fully expected by defendants. The uncontradicted evidence before the district court showed that, in planning for the "conversion," Velsicol's actuaries advised them they would have to achieve investment results of at least 9% per year in order to keep pension costs from continually escalating. Velsicol's internal documents (which were before the district court) thereafter reflect that Velsicol's president forwarded to the president of Velsicol's parent company a summary showing that the estimated total annual cost to Velsicol of the new plan would be less than one-half the cost of the profit sharing plan immediately before the conversion. As set forth above, that prediction was completely accurate: not only did the investment results allow a substantial reduc-

tion in Velsicol's contribution costs, but the last three years for which results were available (1980, 1981, and 1982), Velsicol's contribution was *zero* dollars.

An examination of the trust fund investment portfolio indicates strong basis for defendants' belief that they could easily double the 5% "guarantee" they were going to provide the Class Member Participants under the new plan. The uncontroverted evidence before the district court was that, at the time of conversion, a substantial portion of the trust fund portfolio was in risk-free, blue-chip bonds paying between 9% and 9.75%, *i.e.*, roughly double the 5% guaranteed to Class Member Participants.

One important difference between the profit sharing plan and the pension plan is to be noted as relates to investment rates. Under the Profit Sharing Plan, investment results (either good or bad) did not affect Velsicol's contribution obligations; contribution obligations were pegged to the company's profits. Conversely, under a pension plan, the company's contribution obligations are directly linked to investment results; the better the results, the less the company is required to contribute.

Proceedings Below

In March of 1981, Plaintiff Robert Hickerson filed a three-count complaint in the Circuit Court of Cook County, Illinois alleging breach of contract, breach of fiduciary duty and violation of ERISA. Each count was brought as a class action. The suit was removed by defendants to the United States District Court for the Northern District of Illinois. The district court subsequently granted defendants' motion to dismiss the two common law counts, and granted plaintiff's motion for class certification. After notice had been given to the Class and members were

given the opportunity to opt out, the parties presented cross-motions for summary judgment.

In an October 4, 1983 Memorandum Opinion And Order, the district court denied defendants' motion for summary judgment and granted the Class's motion for partial summary judgment. The court found that the defendants had violated three provisions of ERISA: (a) Section 404(a)(1)(A), which requires that fiduciaries discharge their obligations for the exclusive benefit of plan participants; (b) Section 406, which prohibits the use of plan monies directly or indirectly for the benefit of the employer; and (c) Section 404(a)(1)(D), which requires fiduciaries to discharge their duties in accordance with plan documents. Having found liability, the Court scheduled subsequent proceedings with respect to damages. Following expert actuarial discovery, the parties entered into a stipulation with respect to damages whereby judgment was entered totalling $4 million in damages to the Class through December 31, 1983 and providing that Class members who were still employed by Velsicol would thereafter receive such adjustments to their individual account balances as actual investment results dictated.

Finding it "a close case" and acknowledging that "we have been able to unearth nothing in the statutes, regulations, cases or commentary which could be regarded as dispositive of the issues raised by the plaintiffs," the Court of Appeals for the Seventh Circuit nonetheless reversed and remanded. The Court constructed a mathematical formula for determining the legality of such conversions under ERISA:

> The present value immediately after conversion of the minimum benefit under the Present Plan at normal retirement age equals the account balance plus the specified rate of interest (here, 5%) compounded over

the period from April 1, 1975 to normal retirement age, discounted to April 1, 1975. Thus the present conversion is acceptable so long as the discounted value of the account balance plus the specified interest equals or exceeds the account value.

A petition for rehearing and suggestion of rehearing *en banc* was denied.

REASONS FOR GRANTING THE WRIT

INTRODUCTION

In the proceedings below, defendants have often advised the courts that the decision in the case at bar will impact on "scores of plans around the country" which have made similar "conversions." Given the enormous importance of pension and profit sharing plans in American life today and given the perceived "closeness" of the case and the Court of Appeals' acknowledged lack of dispositive authority, review by this Honorable Court would seem particularly appropriate. The Seventh Circuit has decided an extremely important point of federal law which has not been, but should be, settled by this Court.

Three aspects of the Seventh Circuit's opinion, however, give heightened importance to the appropriateness and necessity of review by this Court. The first such aspect of the Seventh Circuit's decision is the acknowledgement that, had the case been tried under traditional principles of fiduciary trust law, judgment in favor of the Class would have been affirmed. If it is to be decided that ERISA has in fact *narrowed* the protections heretofore afforded profit sharing plan participants under the com-

mon law, such a pronouncement should come from this Court since (a) it is an important point of federal law never established by this Court and (b) such a decision impacts on *all* pension and profit sharing plans across the country, not just the substantial number which have undergone "conversions" such as the one in the case at bar. This is discussed in Section I below.

The second critical aspect of the Seventh Circuit's decision is its creation of a "reasonableness" exception to ERISA's "Prohibited Transactions" section, Section 406. As drafted by Congress, Section 406 allows no such exception for transactions between a plan and a party in interest. This Court has never recognized such an exception (indeed, no court has), and the creation of such a major exception plainly constitutes such an important point of federal law as to warrant this Court's review. This is discussed in Section II below.

The third important aspect of the Seventh Circuit's ruling heightening the need for review is the determination that profit sharing plan participants do not have something akin to an "ownership" interest in their 100%-vested profit sharing monies. Such a ruling is contrary to established law and, again, impacts profoundly and directly on all profit sharing plan participants in the country. Such an important decision as to the nature of participants' profit sharing interests should be, and has not been, settled by this Court. For this additional reason, review should be granted. This is discussed in Section III below.

I.

THE SEVENTH CIRCUIT'S OPINION HAS REMOVED FROM ERISA THE RULES AGAINST SELF-DEALING BY FIDUCIARIES WHICH WERE THE HALLMARK OF THE COMMON LAW OF TRUSTS.

By far the most striking feature of the circuit court's opinion in this case is its treatment of the fundamental conflict of interest that permeates the "conversion" in question here. The defendants decided to "guarantee" a return of 5% on the class members' Profit Sharing monies. More importantly, though, defendants *limited* the class members' return to the specified rate of interest and provided that they would use all the "excess" investment returns over and above the specified rate to defray Velsicol's obligation to make contributions to the new pension plan. Obviously, every dollar of so-called "excess earnings" is a dollar that Velsicol did not have to pay.

It is elemental that the lower the specified rate of interest was set, the more the "excess earnings" would be. Simply stated, the situation was—without more, and at the very least—pregnant with the potential for self-dealing and conflict of interest. It is indisputable that under the traditional trust principles applicable in such circumstances, the burden then shifted to the fiduciaries to prove—by clear and convincing evidence—that the specified rate of interest selected by them was proper. To say that they failed to do so is to engage in understatement. The uncontradicted (and incontrovertible) evidence before the court was that, at the very time defendants effected this conversion, the Fund held risk-free fixed income instruments which guaranteed roughly *double* the rate of interest set by them. Indeed, even averaging in figures from as far back as the Eisenhower era (when interest rates were but a fraction of what they were in the mid-70s),

defendants nonetheless set the specified rate some 16% below the 19-year average investment return experienced by the profit sharing fund (which average had been sharply skewed downward by the disastrous 1973-74 stock market depression that was second only to the Great Crash of 1929).*

The conflict of interest in the case at bar was palpable,** and, for decades, the law had always been absolute in conflict of interest situations: *a fiduciary cannot profit from a conflict of interest situation.* See, *e.g., In Re Estate of Daniel Swiecicki,* 106 Ill.2d 111, 477 N.E.2d 488, 491 (1985); *Home Federal Savings and Loan Association v. Zarkin,* 89 Ill.2d 232, 432 N.E.2d 841, 846 (1982). This is true *irrespective* of good faith. *Leigh v. Engle,* 727 F.2d 113, 124 (7th Cir. 1984); *In re Binder's Estate,* 137 Ohio St. 26, 27 N.E.2d 939 (1940).

As the principle was articulated in *Childs v. National Bank of Austin,* 499 F.Supp. 1096, 1101 (N.D. Ill. 1980):

> "Equity imposes upon a fiduciary and trustee a liability that goes beyond the mere equitable rights of the beneficiaries and such a fiduciary may not obtain any profit or advantage from his dealing with the trust property. Equity will divest the fiduciary of any profit so obtained. It does not matter that the trust did not suffer a loss or that the beneficiaries were injured in any way." Citations omitted.

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* The Circuit Court made note of this fact (Opinion, n.18), but only as a passing point of interest; it attached no legal significance to the fact that the rate was set so far below even this historical indicator.

** Hence, when the Department of Labor was asked by a group of participants to review the proposed conversion, it noted that "the employer is, in part, diverting income for the purpose of partially funding the amended pension plan."

This principle (that a fiduciary cannot profit) holds true even if the beneficiary likewise profits, indeed, even quite handsomely. See, *e.g.*, *Leigh v. Engle*, 727 F.2d at 119, n.9, where a breach of fiduciary duty was found even though one of the challenged investments brought the trust a profit of 141% on the investment.

These principles were never disputed in all the briefing in this case nor by the Court of Appeals opinion. Indeed, the Court of Appeals explicitly noted that the district court had decided the case (*i.e.*, had interpreted ERISA's self-dealing and fiduciary provisions) on the basis of these basic trust principles. (Opinion, p. 11) The court noted that defendants had attacked the district court's application of these trust principles as "simplistic" but never again mentioned those principles or the correctness of applying them. The court *did*, however, explicitly note the conflict of interest with which an employer such as Velsicol was faced in setting the interest rate it would pay in such a "conversion." (Opinion, p. 23) With respect, the analysis thereafter is extraordinary. The court explicitly states that Velsicol "has not provided any very compelling justification under ERISA and its regulations—or in simple logic—for its 5% rate. Without such a strong justification rebutting any suggestion of self-interest, we see no basis for biasing the economic calculation involved in choosing a pension funding regime." *Id.* To say that Velsicol "has not provided any very compelling justification" for the 5% rate is to engage in understatement. Not only did Velsicol provide no justification,* but the uncontradicted evidence

* Before the district court, Velsicol had argued that it was not required to pay *any* interest on the Class Member Participants' monies and that, therefore, the 5% was more than adequate. On appeal, Velsicol abandoned that argument and argued that the 5%

(Footnote continued on following page)

was that (a) Velsicol in fact *expected* to see the funds earn at a rate roughly *double* the rate it purported to "guarantee" to Class Member Participants; and (b) at the very time of the conversion it held risk-free fixed interest instruments paying roughly double that rate.

If traditional trust principles had been applied in that circumstance, there is no question but that judgment for the class would be required.* As the class had pointed out to the Court of Appeals, the law has always been that any time a fiduciary engages in self-dealing (which is conceded to have occurred here)—even if the terms of the transaction are fair and reasonable and done in good faith—any profit realized from the transaction must revert to the beneficiary. Hence, Section 205 of the Restatement Of Trusts (Second), Comment d. at page 461 provides as follows:

> "On the other hand, where the trustee purchases for the trust, property owned by him individually, and the property depreciates in value, it is immaterial that the trustee could properly have purchased similar property from a third person and that in such a case he would not have been liable for the loss."

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footnote continued

figure was "reasonable" in light of losses suffered in prior years. The Court of Appeals made note of this shift in Velsicol's position (Opinion, n.17), and noted that "We think that the defendants' concession on interest is correct." (Opinion, p. 22)

* Indeed, even if there had been nothing in the record concerning defendants' expectations of a much higher investment return and their ability to obtain it on a risk-free basis, once it is stated that fiduciaries have "not provided any very compelling justification" for such self-beneficial conduct, that is the end of the case under traditional fiduciary trust law; judgment for the beneficiary is mandated.

The Court of Appeals, however, never attempted to square the very conflict of interest situation it had identified with the law of trusts or with the district court's application of trust principles in interpreting ERISA's self-dealing and fiduciary provisions. Instead, the court constructed a complicated mathematical, actuarial formula for determining whether a violation of ERISA had occurred. The plain import of the court's decision is that conduct which would plainly violate the law of trusts may nonetheless be allowed by ERISA. Stated differently, the court has plainly decided that ERISA has *narrowed* the protection afforded plan participants by the common law of trusts. No basis was presented by the Court of Appeals for this construction nor, it is submitted with respect, does any such basis exist. To the contrary, it seems too clear for debate that, in passing ERISA, Congress meant to incorporate the law of trusts except to the extent that the law of trusts might in some manner prove insufficient to provide adequate protection to participants:

> "[E]ven where the funding mechanism of the plan is in the form of a trust, reliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries." S.Rep. 127, 93rd Cong., 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Ad. News 4865.

Only the year before its decision in the case at bar, the Seventh Circuit had noted the necessity of reading into ERISA the expansive protection intended by Congress:

> "The entire statutory scheme of ERISA demonstrates Congress' overriding concern with the protection of plan beneficiaries, and we would be reluctant to construe narrowly any protective provisions of the Act." *Leigh v. Engle*, 727 F.2d 113, 126 (7th Cir. 1984).

The instant decision is squarely at odds with such a construction of the statute and its protective provisions.

The court's instant decision to withdraw from that approach to ERISA and instead read into this remedial statute a *diminution* of the protection heretofore provided to participants is one which should not be allowed to stand without review. It is simply too important to too many people.

II.

THE SEVENTH CIRCUIT'S CREATION OF A "REASONABLENESS" EXCEPTION TO SECTION 406 OF ERISA (THE PROHIBITED TRANSACTIONS SECTION) IS ERRONEOUS.

Section 406 of ERISA flatly prohibits transactions between a plan and a party in interest* where the effect of the transaction "constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest, or any assets of the plan." Every court which has ruled on the issue has determined that the section establishes a *per se* prohibition against the specified transactions. See, *e.g.*, *Cutaiar v. Marshall*, 590 F.2d 523, 529 (3d Cir. 1979); *McDougall v. Donovan*, 552 F.Supp. 1206, 1214-15 (N.D. Ill. 1982). The opinion below, however, now creates a "reasonableness" exception for the section.

That the conduct in question here constitutes precisely such a "direct or indirect use by or for the benefit of" Velsicol of the assets of the plan is too clear for argument. The impact of the 5% "guarantee" device is graphically demonstrated by Velsicol's use of the so-called "ex-

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* The section does recognize certain specific exemptions, none of which is claimed to be present here.

cess earnings" to defray—and eventually eliminate—its pension contribution obligations under the new plan. (See pages 5-7 above.) The district court only stated the obvious* when it ruled,

> As a result, any excess profits beyond the "guaranteed" 5% must be viewed as funding the pensions of all Velsicol employees, including those new employees who did not participate in the Profit Sharing Plan. Consequently, whether it be deemed direct or indirect, Velsicol benefitted through reduced plan contributions only because Class Members were not given the full amount earned on their principal which had been carried over from the Profit Sharing Plan. District Court Opinion 40a.

The Seventh Circuit, however, reversed the district court's judgment in favor of the class without ever explaining how Section 406's unambiguous language could be ignored in these circumstances. At no point did the court ever dispute that Velsicol *did* have the direct or indirect use or benefit of the plan's assets; indeed, to the contrary, the court expressly noted the "strong financial interest" Velsicol had in the funding and in the possibility of "self-interested plan administration." Opinion, p. 23. Instead, without ever *mentioning* the existence of Section 406 of ERISA, the Seventh Circuit reversed and remanded for a determination as to the "reasonableness" of the 5% paid to class members.

This is not to suggest, however, that the court was unaware of Section 406's provisions. To the contrary, the court was explicit in this regard. Hence, in the course

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* As previously noted, when the Department of Labor was asked by a group of participants to review the conversion in question here, the Department noted that "the employer is, in part, diverting income for the purpose of partially funding the amended pension plan."

of its discussion and ultimate conclusion that participants did not have an individual "ownership" interest which would prohibit the conduct in question here, the court in a footnote made explicit note of the fact that this did not end the inquiry—that there *still remained* the question of inurement of benefit to Velsicol from this device:

> One is still required, however, to examine the question whether the conversion resulted in inurement of benefit or diversion of assets directly or indirectly to Velsicol. See *infra* Part IV. Opinion n.14.

But when one reads Part IV of the court's opinion, one finds that this question is not addressed at all. All one finds in Part IV of the court's opinion is a discussion of whether the participants received a "going rate" of interest on their Profit Sharing Plan accounts and the conclusion that, in effect, if the specified rate they received on their Profit Sharing Plan balances was reasonable in light of available appropriate investments at that time the conversion was legal "under ERISA." Opinion p. 26. No explanation is given as to the court's authority for substituting "reasonableness" or "fairness" (Opinion p. 27) for the unequivocal prohibition set out in Section 406.

It is respectfully suggested that Congress was very deliberate in prohibiting transactions between plans and parties-in-interest and limiting exceptions from that prohibition to specific, carefully-described instances (none of which is claimed to be present here). The Seventh Circuit's Opinion, however, effectively jettisons that entire section and holds, in effect, that such transactions *will* be allowed if they are, in the judgment of a court, "reasonable" or "fair." That ruling is nothing less than revolutionary and, it is respectfully submitted, must not be allowed to stand. The ruling is an invitation for employers to engage in the very sort of conduct which ERISA was intended to eradicate.

III.

THE SEVENTH CIRCUIT FUNDAMENTALLY MISPERCEIVED THE "OWNERSHIP" INTEREST WHICH PROFIT SHARING PLAN PARTICIPANTS HAVE IN THEIR FULLY-VESTED ACCOUNT BALANCES.

As the Seventh Circuit saw the issue,

> If the interest [which Profit Sharing Plan Participants had in their fully-vested account balances] was akin to an "ownership" interest or to the interest of an income beneficiary in an ordinary trust not subject to unilateral amendment, then presumably these participants in the Former Plan may not be divested of the investment return actually realized by the fund in which they had such an interest. On the other hand, if it was not, their equities in the account balances could have been cut off or limited at the time of conversion, and they would not have a claim to future investment earnings. Opinion, p. 8.

Ultimately the court concluded that "while the trust documents are consistent with the proposition that plaintiffs acquired a sort of vested interest in the *trust* as of the time of conversion (as is conceded by the defendants), they do not suggest that plaintiffs had an interest in the *assets* of the trust fund sufficient to carry with it the earnings of the fund in the years following the conversion." (Opinion, p. 15; emphasis in original) With respect, that conclusion is inconsistent with the accumulated body of law concerning the nature of profit sharing plan participants' interest in such plans, and, indeed, is inconsistent with other portions of the court's own opinion.

Without getting into a tautological debate as to the first portion of the court's phrasing as to whether participants have something akin to "an ownership interest" in their fully-vested profit sharing plan accounts, it seems obvious that under the court's phrasing of the question as to

whether participants' interests in their fully-vested profit sharing accounts is akin "to the interests of an income beneficiary in an ordinary trust not subject to unilateral amendment," that question *must* be resolved favorably to the Class. Indeed, having once phrased the issue thusly, the court never explained in what way the participants' interests in their fully-vested profit sharing funds was *not* akin "to the interest of an income beneficiary in an ordinary trust not subject to unilateral amendment." With respect, it seems apparent that under the court's very own phrasing of the question, the district court's opinion should have been affirmed. This becomes readily apparent when the Velsicol Deferred Profit Sharing Plan is considered. Paragraph 1.2 thereof expressly provides that:

> "The plan is established for the purpose of enabling certain employees of the Company . . . to share in the consolidated net profits of the Company, as hereinafter defined, through the distribution of [sic] them or their beneficiaries, in accordance with the provisions hereof, *of the corpus and income of the trust fund* which is established and maintained as a part of the plan for *their exclusive benefit.*" Profit Sharing Plan, par. 1.2; emphasis added.

And, while the profit sharing plan did allow for amendment, it was explicit that in no event could any modification or amendment be allowed which would permit

> "any part of the trust fund . . . to be used for, or diverted to, purposes other than for the exclusive benefit of the participants, their beneficiaries, or their estates, and provided further, that no such modification or amendment shall operate to reduce or eliminate the account of any person or persons acquired prior to the effective date of such modification or amendment, except modifications or amendments which are necessary to establish or maintain, without interruption, the qualification of the trust for tax-exemption

under the Internal Revenue Code (as amended from time to time) and the regulations promulgated thereunder." Profit Sharing Plan, par. 8.2, Appendix at 49a.

In short, the Plan's provisions regarding amendments forcefully demonstrate that the nature of the participants' interest in their fully-vested profit sharing plan account balances was *precisely* akin to the interests "of an income beneficiary in an ordinary trust not subject to unilateral amendment." In other words, while there could be amendment to the profit sharing plan (just as there could be to most trusts), no amendment was permissible which could affect the participants' fully-vested interests.* Inexplicably, while the court made specific note of paragraph 8.2 of the Profit Sharing Plan (Opinion, p. 13), it focused merely upon the fact that the plan could be amended but made *no* note of the far more important point, namely, that no amendment would be permitted which would allow any of the fund money to be used for or diverted to purposes other than the exclusive benefit of the participants or which would reduce the account of any person (whether or not fully vested) prior to the date of the amendment.**

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* Revealingly, in their Reply Brief before the Court of Appeals, Respondents explicitly acknowledged that the failure to pay any interest post conversion "would reduce accrued benefits." The court explicitly noted this concession (Opinion, n.17) and noted that, "We think that the defendants' concession on interest is correct." (Opinion, p. 22) The court never explained the metaphysics by which it determined that the "ownership interest" participants had must include *some* interest earned on their account balances, but less than all. With respect, we would suggest that the defendants' interest concession is irreconcilable with the court's "ownership" decision.

** To further bolster its analysis concerning lack of an "ownership interest," the court also noted the spendthrift provisions of the Profit Sharing Plan (par. 7.4), the fact that no person is en-

(Footnote continued on following page)

The one provision of the Profit Sharing Plan which the Court of Appeals made no mention of in its analysis of the nature of participants' "ownership interest," was paragraph 6.1 thereof which in relevant part provided as follows:

> All contributions made by the Company and its included subsidiaries under the plan shall be paid into the trust fund thereby created, and all benefits payable under the plan shall be paid from such trust fund. *Neither the Company or any of its included subsidiaries shall have any right, title or interest in the trust fund or in any part thereof, and no part thereof shall revert to the use of the Company or of any of its included subsidiaries.* (Emphasis added.)

If, as the plan document expressly stated, the money once paid into the trust was no longer the company's nor to be used in any way to benefit the company and if under paragraph 8.2 no amendment to the plan could be used to either benefit anyone other than the participants in the plan or to reduce participants' accounts in the plan, it is very difficult to explain the court's conclusion that the participants' interest in the fund was not precisely of the nature which the court described as being sufficient to cause them to prevail.

Moreover, it is most difficult, if not impossible, to square this portion of the court's analysis with its later conclusion that profit sharing plan participants *are* entitled to

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footnote continued

titled to a distribution prior to his Initial Distribution Date (par. 5.1) and that no participant has any interest in or right to "any part of the assets thereof except as and to the extent expressly provided in the plan (par. 7.3). (Opinion, p. 13) These provisions do not distinguish this plan from most private trusts; identical provisions are found in most trusts.

payment of interest on their account balances under the present plan. (Opinion, p. 22) The court's only adversion to the possible implications of this conclusion is to say that this is different from concluding that participants have "a proprietary interest" in those accounts because such a conclusion is "belied by the approach to conversions suggested in the Treasury Regulations." (Opinion, p. 22) The "approach to conversions suggested in the Treasury Regulations" referred to by the court seems to be the Treasury Regulations referred to at pages 16 and 17 of the opinion to the effect that:

> "In the case of a merger of a defined benefit plan with a defined contribution plan, one of the plans before the merger should be converted into the other type of plan (*i.e.*, the defined benefit converted into a defined contribution, or the defined contribution converted into a defined benefit). . . ." Opinion, p. 16, quoting from Treasury Regulation 1.414(1)-1(1).

With respect, the reference to the Treasury Regulation is completely question-begging, for while it suggests that one type of plan *can* be converted into the other and the two merged, the Treasury Regulations provide no guidance as to *how* such a conversion is to be effected. It is to be noted that the court did not purport to find authority for the conduct in question by reference to the Regulations, but merely the "suggestion" that it could be done. The Class's position in this respect is simple: while it may be possible to convert a defined contribution plan to a defined benefit plan, it cannot be done in the manner the defendants have undertaken, and the Treasury Regulations cannot be read as providing otherwise.

In ruling that participants do not have an ownership interest in their fully-vested profit sharing accounts, the court departed from extensive law to the contrary and

created the potential for a whole host of unintended possibilities. Consider, for instance, "cash or deferred" profit sharing plans pursuant to Section 401(k) of the Internal Revenue Code. As was discussed in the briefing before the Court of Appeals, 401(k)s have become one of the most popular employee benefits of recent years; over forty per cent of the Fortune 500 companies have such plans. Under a "cash or deferred" profit sharing plan, an employee has the choice of taking his or her regular salary *or* deferring a portion of it into the profit sharing plan. If the employee defers a portion of his salary, he is not currently taxed upon that portion which goes into the plan. Can there be any question as to the "ownership" of that money, however? Nonetheless, under the Seventh Circuit's opinion, the company could "convert" that profit sharing plan into a pension plan and effectively pocket the "excess earnings" made on the employees' deferred profit sharing money.

Nor is there any meaningful distinction between a profit sharing plan such as the one in the case at bar and a 401(k) profit sharing plan. It is illusory to regard profit sharing plans as anything other than a part of the total compensation package of an employee. Indeed, Treasury Regulations themselves are explicit that:

> "A profit-sharing plan is a plan established and maintained by an employer to provide for the *participation in his profits* by his employees or their beneficiaries. * * * A profit-sharing plan within the meaning of section 401 is *primarily a plan of deferred compensation* . . ." 26 C.F.R. §1.401-1(b)(1)(ii). (Emphasis added.)

Indeed, after the conversion Velsicol continued to demonstrate its recognition of this principle not only by its annual accounting to the members, distinguishing between

"*your* deferred profit sharing account" and "*our* pension plan." (See Appendix, 47a.) For the same reason, defendants readily acknowledged the participants' absolute right to receive the profit sharing portion of their retirement benefit *in lump sum* at retirement. (See Appendix, 48a.)

In so doing, Velsicol was only acknowledging what was heretofore a given in both law and industry: a participant's vested profit sharing money is his "own" money, very much like a savings account. As the Fifth Circuit stated it in *Dennard v. The Richards Group, Inc.*, 681 F.2d 306, 310 (5th Cir. 1982):

> "*Allocation of investment earnings is basically the equivalent to receiving interest on a bank account,* but since the trust fund, or bank account so to speak, consists of accounts for several persons, the interest is divided among them on the basis of account balance ratio." (Emphasis added.)

In concluding otherwise, the Seventh Circuit departed from existing law in an area of widespread importance with implications that reach far beyond the sort of "conversion" attempted here. Such a decision should be reviewed and corrected by this Court.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Dated: April 29, 1986

Respectfuliy submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 84-1608

ROBERT C. HICKERSON, on his own behalf and on behalf of all others similarly situated,

Plaintiffs-Appellees,

v.

VELSICOL CHEMICAL CORPORATION, a Delaware corporation, *et al.*,

Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 81 C 2543—**Stanley J. Roszkowski**, *Judge.*

ARGUED FEBRUARY 20, 1985—DECIDED DECEMBER 3, 1985

Before CUDAHY and POSNER, *Circuit Judges*, and BROWN, *Senior District Judge.**

CUDAHY, *Circuit Judge.* This case arises out of the conversion by amendment of defendant Velsicol Chemical Corporation's defined-contribution deferred profit-sharing plan (the "Former Plan")[1] into a defined-benefit pension

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* The Honorable Wesley E. Brown, Senior District Judge for the District of Kansas, is sitting by designation.

[1] The Velsicol Chemical Corporation and Included Subsidiaries Deferred Profit Sharing Plan.

plan (the "Present Plan").[2] Plaintiff Robert C. Hickerson brought this action individually and on behalf of a class consisting of all Velsicol employees who were participants in the Former Plan at the time of conversion and continued to be employed by Velsicol after conversion, alleging *inter alia* that Velsicol and the trustees of the two plans, also defendants, violated the Employee Retirement Income Security Act of 1974 ("ERISA"), codified primarily in title 29 of the United States Code, when it converted the Former Plan into the Present Plan. The district court granted the plaintiffs' motion for partial summary judgment on the issue of liability, finding that the conversion violated ERISA sections 404(a)(1)(A)(i), 403(c)(1), 406(a)(1)(D) and 404(a)(1)(D), 29 U.S.C. §§ 1104(a)(1)(A)(i), 1103(c)(1), 1106(a)(1)(D) and 1104(a)(1)(D), respectively, and the terms of the Former Plan. *Hickerson v. Velsicol Chemical Corp.*, No. 81 C 2543 (N.D. Ill. October 4, 1983). The parties stipulated the amount of damages, and final judgment was entered. The only issue on appeal is whether the district court erred in concluding that the conversion violated ERISA or the terms of the Former Plan. After giving much consideration to the issue, we conclude that such a conversion does not necessarily violate ERISA or the Former Plan, and thus we reverse the district court's entry of summary judgment. Because we find that a question of fact remains as to whether the terms of this conversion satisfy ERISA and the Former Plan, we remand this case to the district court.

I.

The facts underlying this action are not in dispute, although the characterization of the interests at issue is

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[2] The Velsicol Corporation Pension Plan. The Former Plan and the Present Plan will be referred to together as the "Plan."

sharply contested.[3] The following statement of facts is taken substantially from the district court opinion.

Velsicol adopted the Former Plan on December 1, 1956, and it became effective December 31, 1956. The Former Plan was a defined-contribution profit-sharing plan for eligible salaried employees. Velsicol was to contribute an amount (in its discretion) between 2 and 10 percent of its annual net profits, up to the maximum amount deductible under section 404(a) of the Internal Revenue Code (the "Code"), 26 U.S.C. § 404(a), for the benefit of participating employees. Employees made no contributions to the Former Plan.

Velsicol's contributions were allocated to individual book accounts maintained for each participant. Each year participants would receive a "Statement of Your Personal Account" from the Former Plan trust which informed the participant of the total amount credited to his account at the end of the year. The accounts were periodically credited or debited to reflect the investment gains or losses experienced by the trust. Thus from year to year a participant's account might show an increase, a decrease, or no change, depending upon the relative sizes of Velsicol's contributions and the trust's investment gains or losses. The assets held in the trust were not segregated or earmarked

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[3] The plaintiffs' interest in their accounts is characterized as "ownership" of "property" by the plaintiffs and as a "vested claim" for "equivalent benefits" by Velsicol.

The parties also differ over the characterization of the changes from the Former Plan to the Present Plan:

> There is some dispute among the parties as to whether the defendants[']actions should be characterized as a conversion of the Profit Sharing Plan to a Pension Plan or whether the actions can be characterized as a termination of the Profit Sharing Plan with the newly created Pension Plan introduced as a replacement. All parties, however, agree on the events that transpired; only the legal significance of those events is in dispute.

Dist. Ct. Op. at 4 n.3.

for particular participants but were maintained in a common corpus. Over the eighteen-year period from 1957 to 1975, the investment income of the Former Plan trust corpus averaged 5.77% per year, ranging from a gain of 20.55% in 1971 to a loss of 19.44% in 1974.

Amounts allocated to a participant's account vested on a pro rata basis over a ten-year period, so that any employee who left Velsicol before completing ten years of service forfeited a portion of his account balance. No participant was entitled to a distribution of any portion of his account prior to his "initial distribution date" as defined in the Former Plan.[4] The plan provided that the amount of a participant's account balance would then be paid in one or a combination of specified ways, at the trustees' discretion.[5] Upon the termination or death of an employee whose account had been vested, the full amount would be immediately due and payable. Plaintiff Hickerson and other members of the class had worked for Velsicol for at least ten years and thus had a vested interest in the Former Plan.

The Former Plan was converted to the Present Plan on April 1, 1975. Approximately 563 employees were participants in the Former Plan on March 31, 1975, and they continued to work for Velsicol beyond April 1, 1975. These employees constitute the class Hickerson represents. As of March 31, 1975, the book accounts of these participants in the Former Plan (the "Profit Sharing Participants") be-

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[4] A participant's "initial distribution date" was determined by one of the following events: (1) normal retirement at age sixty-five; (2) retirement, with consent of the employer, at age fifty-five; (3) retirement at any time after December 31, 1957 due to total and permanent disability; (4) death; or (5) termination of employment for any other reason. Former Plan § 5.1.

[5] The three options were: (1) periodic installment payments for up to 10 years, based on account balance at retirement plus simple interest at the legal savings account rate; (2) purchase of an annuity contract with the account balance; or (3) a single lump sum payment of the account balance. Former Plan § 5.2.

came fully vested regardless of length of service and therefore became nonforfeitable. On March 31 the balance in the Former Plan fund was $4,400,154. The named plaintiff, Hickerson, had accumulated a total of $30,485.00 in the Former Plan.

The Present Plan is a defined-benefit pension plan, under which Veliscol promises employees a fixed monthly benefit upon retirement and contributes to the pension fund enough money each year to cover benefits accrued by employees. The Present Plan provides both a standard formula for computing a participant's normal retirement pension (utilizing the participant's total number of months of continuous service) and an alternate method for computing the retirement pension for those employees who had previously participated in the Former Plan. The Present Plan provides that the amount of a Profit Sharing Participant's pension benefits will be the greater of these alternative computations:

> 1) the normal retirement pension computed under the pension formula for *all* continuous months of service,
>
> *or*
>
> 2) the sum of:
>
> > a) the value of the Participant's profit sharing account in the former Profit Sharing Plan as of March 31, 1975, plus interest at 5% compounded annually until retirement, and
> >
> > b) the value of the benefit computed under the pension formula taking into account *only* the months of continuous service earned after March 1975 when the Profit Sharing Plan was converted into the Pension Plan.

See Present Plan, § 6.01(b). Thus, when Velsicol created the Present Plan it guaranteed the Profit Sharing Participants 5% per year on their Former Plan account balances regardless of how the investment of those funds might turn out. Velsicol also provided that all investment

income made on the Present Plan funds (which included the $4.4 million balance from the Former Plan fund) would remain in the Present Plan fund.[6]

The Present Plan attained more than respectable earnings on its funds. According to the district court, the average return actually realized by the pension trust during the seven years following conversion was 11.55%. In addition, the plaintiffs assert that the 1982 investment earnings of the trust fund amounted to 25%. These earnings represent a differential of 6.55% (or more if the plaintiffs are correct about 1982) between the level of earnings guaranteed by the company on Former Plan accounts and the amount actually earned on the funds. It is for this differential that the plaintiffs sue.

The number of participants in the Present Plan has grown as Velsicol has added new employees. The original 563 Profit Sharing Participants have been joined as participants in the Present Plan by some 200-250 new Velsicol employees. Despite the increased number of participants, Velsicol's contributions to the Present Plan fund decreased during the seven years from 1975 to 1982, to the point that in both 1980 and 1981 Velsicol was not required to make any contributions to the fund.

The complaint initiating this action was filed in the Circuit Court of Cook County, Illinois, *Hickerson v. Velsicol Chemical Corp.*, No. 81 CH 2398 (Cir. Ct. of Cook Cty. filed March 31, 1981), and was removed to the federal district court for the Northern District of Illinois on May 7, 1981. The plaintiff's motion for class certification was granted on August 23, 1982, and Hickerson now repre-

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[6] The Internal Revenue Service issued Velsicol a favorable determination letter on November 21, 1977, ruling that the terms of the Present Plan complied with the requirements of the Code. Appendix to Brief for Appellee, at 55. The attention of the IRS had apparently been drawn to the possibility of a reversion of the plan assets to Velsicol by a letter from an official in the Department of Labor, dated November 7, 1977. *Id.* at 14.

sents all Velsicol employees who, as of March 31, 1975, were participants in the Former Plan and who continued to be employees of Velsicol after April 1, 1975. The district court also dismissed counts I and II of the complaint, which asserted violations of common law fiduciary and contractual duties, on the grounds that ERISA preempts state law and is the exclusive source for determining the propriety of defendants' conduct. Plaintiffs do not appeal this dismissal and we express no opinion on its correctness.

The two sides then filed cross motions for summary judgment on count III, which alleged the violations of ERISA at issue here. The district court found that the defendant had violated ERISA, as well as the terms of the Former Plan, by not guaranteeing to the participants in the Former Plan the actual investment earnings on the funds allocated to them as of the time of conversion in 1975. The district court thus entered partial summary judgment on liability for plaintiffs, and the parties stipulated to the amount of damages. Final judgment was then entered, and the defendants appeal.

II.

Although the sort of conversion attempted here—from a profit-sharing plan to a defined-benefit pension plan—does not seem unusual, we have been able to unearth nothing in the statutes, regulations, cases or commentary which could be regarded as dispositive of the issues raised by the plaintiffs. The plaintiffs' basic contention is that they are entitled to the earnings realized since 1975 on the funds allocated to their respective accounts at the time of conversion, even though the Plan purportedly operated on a defined-benefit basis after that date. Thus, the central problem in this case is to determine whether the Profit Sharing Participants have or had an interest in the assets allocated to their accounts in the Former Plan that would entitle them to those earnings.

It is true—and apparently conceded by all parties[7]—that at the time of conversion the Profit Sharing Participants had some sort of vested "interest" in their respective accounts and that no amendment, modification or conversion of the Former Plan could have divested the Participants of such an interest. But there is sharp disagreement as to what that interest was and what rights in the trust corpus it conferred. If the interest was akin to an "ownership" interest or to the interest of an income beneficiary in an ordinary trust not subject to unilateral amendment, then presumably these participants in the Former Plan may not be divested of the investment return actually realized by the fund in which they had such an interest. On the other hand, if it was not, their equities in the account balances could have been cut off or limited at the time of conversion, and they would not have a claim to future investment earnings.

The plaintiffs also rely on the argument that the Former Plan terminated at the time of the conversion and that the original participants, under the provisions of Section 8.3,[8] had a right to a distribution of the funds in their accounts as of that time. A decision about termination requires examination of the terms of the Former Plan and of ERISA.

The impetus of this lawsuit was, of course, provided by the relatively robust investment performance of the pen-

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[7] The district court noted that Velsicol's own actions, in attempting to accommodate the profit-sharing interests and in giving full credit for profit-sharing principal and earnings as of March 1, 1975, belied the defendants' apparent contention in the court below that the employees never had a vested interest in the Plan. Dist. Ct. Op. at 16.

[8] "Upon termination of the plan . . . [t]he amount standing to the credit of each Participant . . . shall represent the final account of each such person . . . . [T]he trustees shall distribute the credit balances . . . in cash or in kind, and with payment thereof by the Trustees, all obligations under the plan in respect of any Participant or other person shall be discharged." Former Plan, § 8.3.

sion trust fund after conversion. As the defendants have pointed out, under a defined-benefit plan the company assumes the investment risk, which prior to conversion here seemed to be considerable. It is not for us to say that Velsicol's assumption of the investment risk and guarantee of pension benefits did not appear ex ante to be legitimately in the best interest of the participants at the time.[9] It may well have also been the case that Velsicol's assumption of the investment risk at that time justified a guarantee of no more than a 5% interest on the Profit Sharing Participants' accounts. Perhaps this was a good bargain that would have been readily accepted by the Profit Sharing Participants had they been given an opportunity to accept or reject it.

For two reasons, however, the fact that the defendants' assumption of the investment risk may have been in the plaintiffs' interest is not determinative of the basic issue. First, the outstanding feature of the period after conversion was not investment risk but rather rich investment reward. The funds which were carried over from the Former Plan into the Present Plan realized large investment gains which in part funded the pension benefits of the employees who became participants in the Plan after conversion; this reduced the requirements on Velsicol to provide funds for the Plan. The plaintiffs have noted in their brief that, partly as a result of the excellent post-conversion investment performance of the funds accumulated prior to 1975, the average contribution to the plan by Velsicol in the seven-year period subsequent to conversion amounted to $311,445. By way of contrast, the average annual contribution by the company to the profit

[9] During the eighteen-year period in which the Former Plan was in operation, the fund's investment earnings averaged 5.77% per year. The yearly earnings fluctuated dramatically, however, from a high of a 20.55% gain (1971) to a low of a 19.44% loss (1974). A gain or loss in any particular year would permanently increase or reduce the retirement benefit of any employee retiring in that year.

sharing plan for the seven years prior to 1975 was $409,334. This, the plaintiffs claim, shows that the fund accumulated and allocated to the accounts of the Profit Sharing Participants before 1975 had "inured to the benefit" of the subsequent participants and Velsicol. It was this arguable inurement of benefits which formed the principal basis for the determination of the district court that there had been a violation of ERISA sections 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A); 403(c)(1), 29 U.S.C. § 1103(c)(1); 406(a)(1)(D), 29 U.S.C. § 1106(a)(1)(D); and 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D).[10]

The second reason why Velsicol's shouldering of risk and the possible attractiveness of the conversion to the Profit Sharing Participants in 1975 is only partially relevant is because the defendants do not rely upon the participants' consent at the time of conversion. Rather, they rely solely upon the power of Velsicol to amend the Former Plan according to its terms. Section 8.2 of the Former Plan provided that the plan might be "wholly or partially amended or otherwise modified" at any time by resolution of the board of directors of Velsicol, subject to the

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[10] ERISA section 403(c)(1), 29 U.S.C. § 1103(c)(1), states that

> the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

Section 406(a)(1)(D), 29 U.S.C. § 1106(a)(1)(D), states that a plan fiduciary

> shall not cause the plan to engage in a transaction, if he knows or should know that such plan constitutes a direct or indirect . . . transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan . . . .

Section 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D), requires that a plan fiduciary

> discharge his duties with respect to the plan solely in the interests of the participants and their beneficiaries and . . . in accordance with the documents and instruments governing the plan . . . .

qualification that no part of the Trust Fund should be used for any purpose other than the exclusive benefit of the participants. The district court held that this provision was violated, as the Trustees' unilateral action exceeded their power to amend. Dist. Ct. Op. at 14.

The district court decided this case for the plaintiffs on the basis of what it conceived to be basic trust principles—"simplistic" principles in the view of the defendants, who have taken strong exception to this approach and have argued throughout that this mode of analysis ignores ERISA and the regulations issued both under it and under the Internal Revenue Code. We think that this is a close case. We do not agree with the plaintiffs that they necessarily suffered grave injustices because of Velsicol's conversion of a profit-sharing plan into a defined-benefit pension plan. However, Velsicol's possibly good intentions and the various incommensurable benefits of shifting from a defined-contribution to a defined-benefit basis do not necessarily lead us to the conclusion that Velsicol was justified in handling matters as it did.

We begin by considering whether a conversion such as that from the Former Plan to the Present Plan may be made under ERISA and the Code and under the terms of the Former Plan. We will then examine whether this particular conversion is satisfactory.

III.

A. Plaintiffs' Asserted Ownership Interest

The plaintiffs assert that under ERISA and under the terms of the Former Plan they have an interest in the assets of the Former Plan trust that precludes the conversion that Velsicol has effected here. While we agree that the plaintiffs have a vested right to a benefit at least equal to the value of their account balances at the time of conversion, we do not think that this vested right is equivalent to an "ownership interest" in the assets, as plaintiffs appear to contend. There is nothing in either

the Former Plan itself or in ERISA and its implementing regulations which would appear to confer on the plaintiffs anything equivalent to an ownership interest; indeed, both suggest that the plaintiffs have only a right to the value of their accounts determined as of the date of conversion. *Cf. Bianchin v. McGraw-Edison Co.*, 438 F. Supp. 585, 588 (W.D. Pa. 1976), *aff'd mem.*, 564 F.2d 89 (3d Cir. 1977), *cert. denied*, 434 U.S. 1047 (1978).[11]

Various provisions of the Former Plan trust seem to militate to one degree or another against the concept that the Participants in effect own the assets which are represented by their various accounts. Thus, section 5.1 of the Former Plan reads:

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[11] *Bianchin*, a pre-ERISA case involving a challenge to the conversion of a profit-sharing plan into a defined-benefit pension plan, is not directly on point because there the conversion was not a unilateral act of the employer but rather was entered into pursuant to a collective bargaining agreement. Its result, however, does tend to support the conclusions we reach here about the nature of a profit-sharing participant's interest in his trust account at the time of conversion. The court held that the only thing "which might be considered 'vested' in the plaintiffs . . . [at the time of conversion]—the resignation *values* of their accounts—were unaffected by the collective bargaining agreement, which more than adequately preserved for each participant the entire *value* of his profit-sharing account as of that date." (emphasis in original).

We also note here *Delgrosso v. Spang & Co.*, 769 F.2d 928 (3d Cir. 1985), which plaintiffs have brought to our attention pursuant to circuit rule 11. It, too, is inapposite to the issues raised in this case. In *Delgrosso*, a defined-contribution plan was converted into a defined-benefit plan six years before the attempted plan amendment which gave rise to litigation. In 1974, when the conversion took place, the Pension Agreement contained a clause that forbade the reversion of any surplus assets in the account to the employer. In 1980, the employer attempted to unilaterally amend the plan so as to allow it a reversion of surplus assets upon termination of the plan. The court held that the employer did not have the power under the Pension Agreement to so amend the plan. *Id.* at 935.

> No Participant shall be entitled to a distribution of any portion of the values standing to his credit in his account prior to his Initial Distribution Date . . . .

Section 7.3 of the Former Plan provides:

> No Participant or other person shall have any interest in, or right to, any part of the assets thereof, except as and to the extent expressly provided in the plan.

Section 7.4 of the Former Plan provides:

> No account in the trust fund shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge, and any attempt so to anticipate, alienate, sell, transfer, assign, pledge, encumber or charge the same shall be null and void . . . .

Section 8.2, which pertains to amendment and modification of the plan,[12] is also important in this regard. Section 8.2 provides that

> [t]he plan may be wholly or partially amended, or otherwise modified, . . . provided, however, that no such modification or amendment shall permit any part of the trust fund . . . to be used for, or diverted to, purposes other than the exclusive benefit of the Participants, . . . and provided further, that no such modification or amendment shall operate to reduce or eliminate the account of any person or persons acquired prior to the effective date of such modification or amendment. . . .

This provision appears to confer a very broad power to amend the plan and thus correspondingly reduces the degree of ownership that the Profit Sharing Participants

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[12] The district court relied specifically on this provision in holding that the provisions of the Former Plan had been violated and therefore that the defendants had violated section 404(a)(1)(D) of ERISA. Dist. Ct. Op. at 14.

can claim. Interpretation of the scope of this section requires a determination of the meaning of "Participants" as used there. The district court apparently construed the word "Participants" to mean only the participants under the Former Plan. But the word could as easily mean not only those covered under the Former Plan but also those who joined the defined-benefit plan into which it was converted. If we view the arrangement as encompassing through amendment the subsequent defined-benefit scheme as well as the earlier profit-sharing plan, it would be more appropriate to construe the word "Participants" as referring to participants in the plan both before and after it was amended.[13] Under that interpretation there is no

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[13] "Participant" was a defined term under the Former Plan, meaning

> [e]ach . . . [salaried employee] who, on or before December 31, 1956, shall have completed the requisite twelve months' service with the Company . . . . Each other employee of the Company or of an included subsidiary shall be a Participant as of the date of the adoption of the plan by an included subsidiary or as of the December 31 next following the date as of which he shall have completed the requisite twelve months of service with the Company, one of its included subsidiaries, or any Affiliated Company.

Former Plan, § 2.2. The Present Plan also defines "Participant," and its definition broadens eligibility somewhat. *See* Present Plan, Article II & § 3.03 (employee becomes a participant on the July 1 or January 1 after he completes a 12-month period in which he has worked 1000 hours).

Assuming an otherwise proper amendment of the plan to effect a different funding mechanism, there is nothing that suggests that this definition would not encompass all participants meeting eligibility requirements, pre- or post-conversion.

On the other hand, suppose that "Participant" had been defined under the Former Plan as the district court implicitly defined it, that is, as referring only to those who participated in the Former Plan. The definition would have been framed in such a way as to account for plan amendments and would have read something like this: "The term 'Participants' shall mean all employees participating in the plan on the date of an amendment but shall not

(Footnote continued on following page)

violation of ERISA with respect to the subsequent participants apparent from the face of Section 8.2. If the plan can be amended legally to allow this conversion, then the ownership interest that plaintiffs claim is conferred by the Plan is by definition not large enough to prohibit such an amendment.[14]

Thus, while the trust documents are consistent with the proposition that plaintiffs acquired a sort of vested interest in the *trust* as of the time of conversion (as is conceded by the defendants), they do not suggest that the plaintiffs had an interest in the *assets* of the trust fund sufficient to carry with it the earnings of the fund in the years following the conversion. *Cf. Bianchin v. McGraw-Edison, supra.*

Having concluded that the Former Plan does not suggest that the plaintiffs have an ownership interest which precludes the conversion here, we turn to ERISA. Surprisingly, ERISA does not appear to discuss the effect

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[13] *continued*
include those who first participate in the plan on a date subsequent to an amendment." This was not the form employed—and with good reason. Consider the following amendment: "All employees who first participate after this date shall have amounts credited to their accounts as at present. However, any earnings of the plan fund greater than 5% which are attributable to such employee's account balance shall not be credited to the employee's account, but may either be used to reduce Velsicol's contribution to the employee's account the following year, or distributed pro rata to current retired beneficiaries of the plan, at the trustee's option." The general form of the district court's interpretation would not prohibit this amendment, yet it seems plain to us that § 8.2 was meant to prohibit such an amendment, which denies benefits to some employees eligible for the plan. This leads us to believe that the proper reading of the definition should be "The term 'Participant' means any employee participating in the plan, whether first participation is before or after the date of an amendment."

[14] One is still required, however, to examine the question whether the conversion resulted in inurement of benefit or diversion of assets directly or indirectly to Velsicol. *See infra* Part IV.

of a plan amendment that converts a defined-contribution plan into a defined-benefit plan. But we do not think that ERISA and the accompanying regulations support plaintiffs' argument because ERISA's fiduciary principles protect employees' claims to accrued benefits, not their ownership of pension fund assets. *See Salazar v. Sandia Corp.*, 656 F.2d 578 (10th Cir. 1981) ("The plaintiffs under the Plan had, and have, a right to retirement benefits but they do not have rights to particular contributions and never did); *cf. Bianchin, supra.* This is demonstrated by the various other transformations, which have the same impact on participants' interests, that ERISA does permit.

In the context of a merger or consolidation of two plans, and the transfer of assets or liabilities between two plans, ERISA and the Code, as elucidated by their accompanying regulations, assume the possibility of the conversion of a defined-contribution plan into a defined-benefit plan. Such a conversion is contemplated as the first step of a merger or consolidation of a defined-contribution with a defined-benefit plan. Treasury Regulation § 1.414(*l*)-1(*l*) provides as follows:

> In the case of a merger of a defined benefit plan with a defined contribution plan, one of the plans before the merger should be converted into the other type of plan (i.e., the defined benefit converted into a defined contribution, or the defined contribution converted into a defined benefit) . . . .

This same general rule is repeated at ERISA § 208, 29 U.S.C. § 1058, and Code §§ 401(a)(12) & 414(*l*), 26 U.S.C. §§ 401(a)(12) & 414(*l*), and also applies when assets or liabilities are transferred between plans.

The validity of the attempted merger under ERISA is measured by comparing the "benefits on a termination basis" of the participants immediately *before* the proposed merger with the benefits on a termination basis of the participants immediately after. Treas. Reg. § 1.414(*l*)-1(a)(2)(ii). *See also* ERISA § 208, 29 U.S.C. § 1058; Code §§ 401(a)(12), 414(*l*), 26 U.S.C. §§ 401(a)(12), 414(*l*) (sub-

stantially similar provisions). The benefits on a termination basis of a participant in a defined-contribution plan is the balance in such a participant's individual account at the time the plan is terminated. 26 U.S.C. § 411(a)(3). This is the amount that ERISA guarantees the participant in the event of such a transaction.

If the conversion of one plan from defined-contribution to defined-benefit and the subsequent merger of the two remaining plans is successfully accomplished, the surviving plan is deemed to be a "single plan" under which the combined assets of both pre-merger plans are available to pay benefits to all post-merger participants, regardless of the allocation of funds in any pre-merger accounts. *See* Treas. Reg. § 1.414(*l*)-1(b)(1).

The participants in the defined-contribution plans which the statute and the regulations allow to be converted to effect a merger have the same vested interest in their account balances that the Profit Sharing Participants have in theirs. Yet their rights to a future income stream from investment earnings that would accrue to them post-conversion is cut off by the conversion. The statute is quite clear that they are entitled to be vested in their accrued benefits and the regulations measure the validity of the merger by whether those values are preserved. But once the merger has taken place, participants have no paramount rights to any portion of the new trust corpus. ERISA does not support the plaintiffs' contention that they have an ownership interest in the assets of the Former Plan trust.

B. Termination of the Plan

Plaintiffs' other principal argument for having what amounts to an ownership interest in the assets of the trust fund, and thus a right to their post-1975 investment earnings, is that the Former Plan terminated at the time of the conversion. If there had been a termination, the Profit Sharing Participants would have been entitled to an immediate distribution of the assets of the Former

Plan trust, 26 U.S.C. § 411(a)(3), which they could have invested in a rising market themselves. But we do not believe that a termination occurred, either under the terms of the plan or by the requirements of ERISA.

The plaintiffs contend that the Former Plan was terminated by operation of its Section 8.3. In the district court the plaintiffs argued that the Present Plan was so entirely different from the Former Plan that the Present Plan could not have been a "continuation" or an "amendment" of the Former Plan. The plaintiffs also argued that in effect the profit-sharing plan has stopped functioning: Velsicol ceased making contributions based on its profits; account earnings no longer accrued directly to the participants; and, in fact, the Present Plan explicitly refers to the profit-sharing plan as the "Former Plan". The plaintiffs therefore contended that the plain language suggests a termination. The district court did not rule on the termination argument, although the plaintiffs renew it in abbreviated form on appeal. *See* Pl. Br. at 34-37.

This argument from the layman's definition of "termination" simply restates the necessary effects of a conversion of a defined-contribution profit-sharing plan into a defined-benefit plan, and if we accept the premise that ERISA allows the conversion of a profit-sharing plan into a defined-benefit plan, the arguments which the plaintiffs make for termination lose their force. Section 8.3 of the Former Plan provided for termination by resolution of the board of directors of Velsicol, or in the event of Velsicol's bankruptcy or insolvency or if there were a corporate merger, consolidation, reorganization or sale of all assets. None of these events occurred. Nor do we believe that any of the applicable statutes or regulations dictate the conclusion that the Former Plan terminated in the course of the attempted conversion of the profit-sharing plan to a defined-benefit pension plan.

The plaintiffs rely on a memorandum written by Velsicol's Vice President for Personnel acknowledging "the 100% vesting" of the account balances as a result of the "legal

requirements" governing the conversion. In this connection, the plaintiffs cite section 411(d)(3) of the Code, 26 U.S.C. § 411(d)(3), which requires full vesting of the rights of affected employees if a plan is terminated, § 411(d)(3)(A), or "upon complete discontinuance of contributions under the plan," § 411(d)(3)(B). We think that there was neither a termination, *see infra*, nor a complete discontinuance of contributions under the plan, as amended. Both sides agree that a form of vesting took place, but we believe that it occurred pursuant to the terms of the amendment, not by operation of law.

We do not believe that ERISA supports the contention that there was a plan termination in this case—for the same sorts of reasons that we do not believe that it gave the plaintiffs an ownership interest in the assets of the Former Plan trust. ERISA contemplates plan amendments and such transactions as plan mergers, consolidations and transfers of assets. In the context of all these, it does specifically state that a conversion from a defined-benefit to a defined-contribution plan causes a plan termination, ERISA § 4041(f), 29 U.S.C. § 1041(f); Treas. Reg. § 1.411(d)-2(c)(2). But there is no suggestion that the reverse action—conversion from defined-contribution to defined-benefit—should be treated any differently than other plan amendments.[15]

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[15] *See* Laarman & Hildebrandt, Plan Terminations and Mergers, at A-18 (BNA Tax Management Portfolio No. 357 (1983)):

> Thus, the amendment of a defined benefit plan into the form of a profit sharing, stock bonus, or money purchase plan would be considered a termination of the defined benefit plan, and all participants would become fully vested in their accrued benefits, under the defined benefit plan, to the extent funded. In the reverse case, however, the issue of whether there has been a complete or partial termination depends on whether the transformation resulted in discrimination, a potential for reversion of funds, or the separation from service of a number of participants formerly covered by the plan.

See also infra note 15.

(Footnote continued on following page)

Generally, a plan amendment should be treated as terminating the plan if such a result is indicated by "all the facts and circumstances," which include: (1) prohibited discrimination between groups of employees under the plan; (2) the exclusion of a group of previously covered employees from the plan; and (3) the creation of a potential for reversion of funds to the employer. *See* 26 U.S.C. § 411; Treas. Reg. 1.411(d)-2(c)(1); IRS Document 6678, "Plan Termination Standards" (April 1981).[16] If none of these three things have occurred, such a plan amendment will not cause a termination. Since there is no claim that a reduction in workforce or discrimination occurred, the question whether a termination occurred when the plan

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[15] *continued*

There is good reason for ERISA to show greater concern when a defined-benefit plan is converted. Under a defined-benefit plan, (1) the employer bears the investment risk on the funds in the pension trust and (2) the assets in a defined-benefit pension trust are federally-insured by the Pension Benefit Guaranty Corporation.

[16] Pre-ERISA Treasury Regulations regarding plan terminations stated that a conversion from one type of plan to another would not result in a plan termination if the original plan was replaced by a "comparable" plan. *See* Treas. Reg. § 1.401-6(b). A pension plan was comparable with another pension plan, and a profit-sharing plan with another profit-sharing plan; a pension plan and a profit-sharing plan were not deemed "comparable." Treas. Reg. § 1.381(c)11-1(d)(4). The post-ERISA Treasury regulations with respect to plan terminations do not, however, discuss comparability, *see* Treas. Reg. § 1.414(*l*) *et seq.* The I.R.S., in Document 6678, "Plan Termination Standards," (April 1981), states that

> The pre-ERISA concept of "comparable plans" as expressed in I.T. Reg. Sec. 1.381(c)(11)-1(d)(4) is not applicable in determining whether a plan that is subject to section 411(d) of the Code has been terminated or partially terminated as a result of changing one type of plan into another by amendment.

The document notes that under § 1.411(d)-2(b)(1) of the regulations, a partial termination of a defined-contribution plan may occur if the "facts and circumstances" show (1) prohibited discrimination between groups of included employees; (2) exclusion of a group of previously covered employees; and (3) the creation or increased likelihood of a reversion of fund assets to the employer. *Id.*

amendment here went into effect will depend upon whether there was a reversion, that is, whether plan assets inured to the benefit of Velsicol. This is the question we discuss next.

IV.

The question remains whether the terms of the conversion undertaken in this case meet the requirements of ERISA and the provisions of the Former Plan itself. ERISA requires that "[t]he accrued benefit of a participant under a plan may not be decreased by an amendment of the plan, . . ." 29 U.S.C. § 1054(g)(1), and the Former Plan contains a similar provision, *see* Former Plan, § 8.2.

The accrued benefit of a participant in a defined-contribution plan is the balance allocated to his individual account, ERISA § 3(23)(B), 29 U.S.C. § 1002(23)(B), and the defendants readily concede that they must provide the Profit Sharing Participants a minimum benefit based on the value of the accounts allocated to the various members of their class at the time of conversion. They now apparently also concede that the Profit Sharing Participants are entitled not only to the value of the profit-sharing accounts but also to interest on those accounts;[17]

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[17] In the appendix to their reply brief defendants recite as one of plaintiffs' arguments: "Under defendants' argument regarding accrued benefits, an employer can freeze a plan and pay no interest on plan accounts." Defendants then summarize their response as follows: "Defendants do not so argue. Such a hypothetical action would reduce accrued benefits and Velsicol has never contended otherwise." App. to Reply Br. at 6a. This seems to be a change from the position which defendants took in the trial court, where they asserted that, "If it desired, Velsicol could have provided in the Pension Plan that the minimum pension benefit would be the profit sharing balance *without adjustment.*" Defendants' Memorandum in Support of Their Motion for Summary Judgment on Count III of the Complaint, at 13 (emphasis supplied).

they have also included in the minimum benefit interest on the account balances compounded at 5%. We think that the defendants' concession on interest is correct; the Profit Sharing Participants are entitled to a payment of interest on their account balances under the Present Plan since the funds are not being distributed to them to invest. But we do not agree with plaintiffs' claim to the earnings actually realized by the trust and ascribable to those accounts in future years. Such a return suggests a proprietary interest in the trust accounts which is belied by the approach to conversions suggested in the Treasury Regulations, *see supra.* Further, such a rate of return seems inequitable as a part of a scheme in which Velsicol has insured the participants against falling interest rates. Plaintiffs have not suggested that, had the market not performed so well (or interest risen so high), Velsicol might have reduced the vested post-conversion profit-sharing benefit to track investment losses incurred by the Present Plan Fund.

Nor, however, do we think that the 5% adjustment specified in the Present Plan meets the requirements of ERISA and the Former Plan. Velsicol attempts to justify the 5% figure on the grounds that this is the rate that ERISA requires to be paid on mandatory employee contributions to defined-benefit plans, ERISA § 204(c)(2)(C), 29 U.S.C. § 1054(c)(2)(C). Velsicol also notes that the Former Plan itself provided that the Trustees of the Plan could determine how the benefits were to be distributed when the employees became entitled to them and specified that one option was a long-term installment payment, at a simple interest rate equal to the rate paid on savings accounts by the bank holding the trust assets. At the time of conversion, that rate was subject to a maximum set by the Federal Reserve under its regulation Q, then 5%.[18]

[18] Velsicol also briefly mentions that 5% is an acceptable rate because the average return on the Former Plan assets from 1956

(Footnote continued on following page)

All of this may be true but, of course, none of these provisions applies directly to account balances in profit-sharing plans which have been converted to defined-benefit plans nor addresses the possibility of a reversion caused by the conversion. The rate at which profit-sharing participants are to be compensated for the holding of their accounts beyond the time of conversion is a very sensitive determination.[19] To peg the interest rate too low is to shift the probabilities for a firm making such a conversion toward a reduced funding burden in future years. Defendant has noted the importance as a policy matter of permitting employers to convert plans in order to accommodate the company's own financial condition and serve the interests of employees. This is why ERISA allows plan amendment. But it is a different matter to permit this flexibility to become the basis for frequent changes in funding methods in an attempt to generate a windfall through conversion. Plan trustees are fiduciaries under a strict duty to deal with the funds entrusted them solely to the benefit of plan participants, ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1); *see Leigh v. Engle*, 727 F.2d 113 (7th Cir. 1984). Since Velsicol has a strong financial interest in the way in which its pension plan (to which, pre- and post-conversion, it was the sole contributor) is funded, it must ensure that there is no suggestion of self-interested plan administration. It has not provided any very compelling justification under ERISA and its regulations—or in simple logic—for its 5% rate. Without such a strong justification rebutting any suggestion of self-interest, we see no basis for biasing the economic calculation involved in choosing a pension funding regime.

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[18] *continued*
to 1975 had been 5.77%. We decline to embrace this justification. Past investment performance is not necessarily an accurate gauge of future performance. Further, had Velsicol meant to give a rate that mirrored the prior performance of the fund, why did it not give 5.77%?

[19] No provisions of the statute or of the regulations directly address this issue.

Thus, we believe that the benefit of the doubt belongs to the Participants and that their vested benefit under the Present Plan should be calculated to include a rate of interest on the profit-sharing balances which would realistically approximate their prospects of earning interest on the account balances if the balances were in their hands over the years. We mean, of course, a going interest rate as of April 1, 1975, not a rate calculated with hindsight from the perspective of 1982 or 1985. Such a result would not create incentives for the conversion of plans following changes in the market and would ensure that the assets in the pension fund were not being used to benefit the employer. The detailed regulations that measure the validity of a merger of a defined-contribution and a defined-benefit plan are instructive in this regard because it is their purpose to prevent such a reversion in that context.[20]

As discussed *supra* Part III, when a defined-benefit and defined-contribution plan are to be merged, one plan is converted to a plan of the other type before the merger takes place. Then the plans are merged and the validity of the conversion and merger are measured by a general criterion which requires that each participant receive

> benefits on a termination basis . . . from the plan immediately after the merger, consolidation, or transfer which are equal to or greater than the benefits the participant would receive on a termination basis immediately before the merger, consolidation or transfer.

Treas. Reg. 1.414(*l*)-1(a)(2)(ii). *See also* ERISA § 208, 29 U.S.C. § 1058; IRC §§ 401(a)(12), 414(*l*), 26 U.S.C. §§ 401(a)(12),

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[20] We note that the regulations state that this procedure is to be used only when two plans are involved and not "merely because a defined-contribution plan is amended to become a defined-benefit plan," Treas. Reg. §1.414(*l*)-1(c). But because the regulations were promulgated to deal with the same problem we face here, *i.e.*, to ensure that each participant retains his accrued benefit and that such value does not inure to the benefit of the employer, we find them instructive.

414(*l*) (substantially similar provisions). The term "benefits on a termination basis" is a defined term in the regulations, meaning "the benefits that would be provided exclusively by the plan assets pursuant to . . . [ERISA] and the regulations thereunder if the plan terminated." Treas. Reg. § 1.414(*l*)-(1)(b)(5)(i).

Thus, the regulations require that before- and after-merger benefits be determined as if there had been a termination and that the post-merger value of the benefits must be at least as great as their pre-merger value. By analogy, the conversion here at issue would appear to prevent a prohibited reversion so long as the benefits on a termination basis under the Present Plan equal or exceed the benefits on a termination basis under the Former Plan.

Since all the assets of the Former Plan were allocated to individual accounts which would be paid to the participants if the plan were terminated, 26 U.S.C. § 411(d)(3), each participant's benefit on a termination basis immediately prior to the conversion was his or her accrued benefit, the account balance, *see* ERISA § 3(23)(B), 29 U.S.C. § 1002(23)(B). The benefit on a termination basis of the Present Plan immediately after the conversion—on April 1, 1975—was the present value (that is, the discounted value immediately after conversion) of the minimum annual benefit commencing at normal retirement age. The minimum value of the benefit starting at normal retirement age for Profit Sharing Participants under the Present Plan would be the participant's Former Plan account balance plus the specified interest plus a benefit calculated for post-conversion service. Since this calculation is based on a hypothetical plan termination immediately after conversion, there would be no post-conversion service and so no additional benefit based on that. Thus the minimum benefit at normal retirement age would be the account balance plus the specified interest compounded until normal retirement age, and the present value of this benefit, or the benefit on a termination basis, would be arrived at by discounting for the appropriate rate of interest

prevailing at time of conversion. Thus it seems to us that ERISA would authorize a conversion such as that attempted here so long as the account balance under the Former Plan as a conversion was equalled or exceeded by the present value immediately after conversion of the participant's minimum benefit at normal retirement age, which here equals account balance plus specified interest.

The present value immediately after conversion of the minimum benefit under the Present Plan at normal retirement age equals the account balance plus the specified rate of interest (here, 5%) compounded over the period from April 1, 1975 to normal retirement age, discounted to April 1, 1975. Thus the present conversion is acceptable so long as the discounted value of the account balance plus the specified interest equals or exceeds the account value. This will be the case so long as the specified interest rate, compounded from conversion to normal retirement age,[21] equals or exceeds the discount rate for funds held for that period of time. This will, of course, approximate the long-term interest rate as of the date of conversion. Here neither party has attempted to establish what the realizable market rate of interest was on April 1, 1975. If that rate was less than or equalled 5%, which is the specified interest rate of the Present Plan, the conversion would clearly be acceptable under ERISA. Insofar as the market rate of interest exceeded 5% on April 1, 1975, the Present Plan must provide interest on the account balances at least equal to that realizable market rate of interest in order to be an acceptable conversion under ERISA.

The concept of "benefits on a termination basis" suggests valuation of benefits *as if* there were a right to their possession immediately before or after conversion. This

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[21] We see no reason why Velsicol may not, for ease of calculation, use an appropriate actuarial figure for the class of participants instead of calculating each participant's normal retirement age, and benefits on a termination basis, separately.

adjustment (which is represented by what we have called the "specified interest") is, of course, quite different from the one claimed by the plaintiffs, which is based on the actual earnings of the trust fund. Rather the adjustment reflects an *ex ante* projection of the interest which a Participant could have earned had he or she received the accrued benefits at the time of conversion. This rate must be a going rate—not an arbitrary rate prescribed for some other purpose—and since its calculation is economically crucial, it should be based on the actual circumstances of the money market as best they can be determined at the time of conversion.[22] We think that such a going rate would be fairer and more reasonable than the 5% prescribed in the Present Plan.[23]

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[22] In the ordinary case, the Trustee would have to determine the appropriate rate before undertaking the conversion and we think this process should not be overly complex or expensive. We would not want to see the Trustee have to defend against frivolous challenges to the figure he has arrived at in good faith and with due diligence. Rather we suggest that the Trustee look to comparable alternative investments, for example annuities or long-term government securities. To avoid endless haggling over tax effects and risk factors, we propose that the trustee's choice of a rate be accepted if it is based on the appropriate standard (going rate on alternative investments), is supported by substantial evidence (probably in the form of qualified expert opinion) and is not arbitrary. The 5% rate in the conversion now before us represented, *inter alia*, the interest paid on savings accounts, which have not been shown to be comparable investments for these purposes.

[23] In the unlikely event it should turn out that the prescribed 5% is higher than the market rate, the plaintiffs, would, of course, be entitled to the higher rate.

Should the more likely event occur and the district court find that the relevant going rate of interest was higher than 5%, the defendants may offer evidence before the district court tending to show that the alternative benefit guaranteed by Present Plan § 6.01(b)—a defined benefit representing the employee's years of service prior to April 1, 1975—preserved the value of the plaintiffs' claims to accrued benefits.

Hence, the district court should not have granted either the defendants' motion for summary judgment or the plaintiffs' motion for partial summary judgment. The case is REVERSED AND REMANDED to the district court for a determination of a realizable fair return based upon a going interest rate that might have been earned by the participants in the profit-sharing plan had the plan been terminated and had they received the amounts in their accounts on the date of conversion, and for other proceedings not inconsistent with this opinion. Circuit Rule 18 shall not apply.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

January 29, 1986

Before

Hon. RICHARD D. CUDAHY, *Circuit Judge*
Hon. RICHARD A. POSNER, *Circuit Judge*
Hon. WESLEY E. BROWN, *Senior District Judge**

ROBERT C. HICKERSON, on his own behalf and on behalf of all others similarly situated,

Plaintiffs-Appellees,

No. 84-1608 vs.

VELSICOL CHEMICAL CORPORATION, a Delaware corporation, *et al.*,

Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 81 C 2543—**Stanley J. Roszkowski,** *Judge.*

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* The Honorable Wesley E. Brown, Senior District Judge of the District of Kansas, is sitting by designation.

ORDER

On consideration of the petition for rehearing and suggestion for rehearing *en banc* filed in the above-entitled cause by the plaintiff and appellee class, no judge in active service has requested a vote thereon, and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ROBERT C. HICKERSON, on his own behalf and on behalf of all others similarly situated,

Plaintiff,

No. 81 C 2543 vs.

VELSICOL CHEMICAL CORPORATION, a Delaware corporation; THE NORTHERN TRUST COMPANY, an Illinois banking corporation, as Trustee of the Velsicol Chemical Corporation Pension Plan; BEN W. HEINEMAN; PAUL J. WEIR; BERNARD FIRESTONE; ROBERT R. GARRISON; and THE RETIREMENT COMMITTEE OF THE VELSICOL CHEMICAL CORPORATION PENSION PLAN,

Defendants.

MEMORANDUM OPINION AND ORDER

Before the court is defendants' motion for summary judgment and plaintiff's cross motion for partial summary judgment on the issue of liability. Plaintiff brings this action individually and on behalf of a class consisting of himself and all Velsicol Chemical Corporation ("Velsicol") employees, who as of March 31, 1975, were participants in the Velsicol Chemical Corporation and Included Subsidiaries Deferred Profit Sharing Plan (the "Profit Sharing Plan"), and who continued to be employees of Velsicol subsequent to April 1, 1975. The complaint names as defendants Velsicol, the Trustees of the Profit Sharing Plan, and the Northern Trust Company, Trustees of the Velsicol Chemical Corporation Pension Plan.

For the reasons stated herein, plaintiff's motion for partial summary judgment is granted and defendants' motion for summary judgment is denied. Jurisdiction is based upon 28 U.S.C. § 1331(a) and 29 U.S.C. § 1132(e).

The issue before the court is whether Velsicol's 1975 conversion of the employee profit sharing into an ERISA pension plan violated the protective provisions of the Employee Retirement Income Security Act, 29 U.S.C. § 1001, *et seq.*

The parties acknowledge the undisputed facts to be as follows:

FACTS

A. The Velsicol Profit Sharing Plan

Velsicol adopted the Profit Sharing Plan on December 1, 1956 (predating the enactment of ERISA). Velsicol was to contribute 2 to 10 percent of its annual net profits for the benefit of participating employees; plan participants did not contribute to the fund. Velsicol's contributions were allocated to individual book accounts maintained for participating salaried employees.

Each year participants would receive a "Statement of Your Personal Account" from the Velsicol Chemical Corporation Deferred Profit Sharing Trust which informed each of the participants of the total amount credited to his account at the end of the year. The accounts were also periodically credited or debited to reflect investment gains and losses experienced by the trust.

Over the eighteen year period from 1957 to 1975, the Profit Sharing's fund investment income averaged 5.77% per year.[1] Amounts allocated to a participant's account vested on a pro rata basis over a ten year period, so that termination of service within ten years would result in forfeiture of a portion of the benefit. No participant was

entitled to a distribution of any portion of the values allocated to his account prior to the "initial distribution date" as defined in the Plan.[2]

Plaintiff and other members of the Class worked for Velsicol for at least ten years and had a vested interest in the Profit Sharing Plan. Upon termination or death of an employee, the full amount of his account in the Profit Sharing Plan would be immediately due and payable.

As of March 31, 1975, the book accounts of the Profit Sharing participants became fully vested and were therefore nonforfeitable. The balance in the Profit Sharing Trust Fund was $4,400,154. The named plaintiff, Hickerson, had accumulated a total of $30,485.00 in the Profit Sharing Plan.

Approximately 563 employees were participants in the Profit Sharing Plan on March 31, 1975 and they continued to work for Velsicol beyond April 1, 1975.

B. The Velsicol Defined Benefit Pension Plan

On April 1, 1975, the Profit Sharing Plan was "converted" into and replaced by the Velsicol Defined Benefit Pension Plan.[3] Under the Defined Benefit Pension Plan, the benefits to be received by participants were fixed. Velsicol's contributions were adjusted, in an amount computed by the Plan actuary to comply with the funding Standards of Sections 302-306 of the Employee Retirement Income Security Act, 29 U.S.C. §§ 1001 *et seq.* ("ERISA"), and Section 412 of the Internal Revenue Code, 26 U.S.C. § 412. Participants did not make any contributions to the Pension Plan.

The Pension Plan provided a standard formula for computing a participant's normal retirement pension utilizing the participant's *total* number of months of continuous service. However, it also provided an alternate method for computing the normal retirement pension for those employees who were also participants in the former Profit Sharing Plan (the "Class Member Participants"). The Pen-

sion Plan provided that the amount of Class Members' pension benefits would be the greater of two alternative computations:

1) the normal retirement pension computed under the pension formula for *all* continuous months of service *or*

2) the sum of:

a) the value of the Class Members' profit sharing account in the former Profit Sharing Plan as of March 31, 1975, plus interest at 5% compounded annually until retirement and

b) the value of the benefit computed under the pension formula taking into account *only* the months of continuous service earned after March 1975 when the Profit Sharing Plan was converted into the Pension Plan.

When Velsicol created the Pension Plan, it provided that Velsicol would "guarantee" the Class Member Participants 5% per annum on their Profit Sharing account balances.

Velsicol also provided that all investment income made on the Pension Fund (which included the $4.4 million from the Profit Sharing Trust corpus) would stay in the Pension Plan, thereby benefiting both Profit Sharing and non-Profit Sharing participants.

C. Participant Growth, Investment Return and Company Contributions Under the Pension Plan after April 1, 1975

The number of employees participating in the Pension Plan continued to grow as the company added new employees. The original 563 employees who worked for the company on March 31, 1975 and who had worked under the Profit Sharing Plan were eventually joined by 200-250 new Velsicol employees ("Non-Class Member Participants") under the Pension Plan.

The Pension Plan also attained respectable earnings on its funds. During the seven year period following the es-

tablishment of the Pension Plan, the average return received on the Pension Fund was 11.55% per year.[4] These earnings represent a 6.55% differential between the level of earnings guaranteed by the company on former profit sharing funds (5%) and the level actually earned on the funds (11.55%).

Because the fund's earnings greatly exceeded the earnings guaranteed by the company, Velsicol's contributions to the Pension Fund decreased during these seven years to the point that, in 1980 and 1981 Velsicol made no contributions to the Pension Fund.[5]

CONTENTIONS OF THE PARTIES

The parties' dispute centers upon the 6.55% differential between the earnings guaranteed under the fund and the amount actually earned. The plaintiff class contends that the extra earnings have been used unlawfully to benefit the company by reducing its contributions to the plan; plaintiff contends those extra earnings should have inured exclusively to the benefit for the former profit sharing plan participants.

The class contends that the company's derivation of benefit from the plan's earnings violates ERISA in several respects. *First*, that the defendants violated Section 404(a)(1)(A)(i) of ERISA, 29 U.S.C. § 1104(a)(1), which requires a fiduciary to discharge his duties "solely in the interest of participants" and for their exclusive benefits; *second*, that the defendants violated Section 403(c)(1), 29 U.S.C. § 1103(c)(1), which provides that the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive benefit of plan participants; *third*, that the defendants violated Section 406(a)(1)(D) of ERISA, 29 U.S.C. § 1106(a)(1)(D), which prohibits fiduciaries from engaging in self-dealing transactions involving conflicts of interests with the plan; *fourth*, that the de-

fendants have violated Section 404(a)(1)(D) of ERISA, 29 U.S.C. § 1104(a)(1)(D) which requires a fiduciary to act in accordance with plan provisions. As to this fourth argument, the class argues that the defendants failed to administer the Profit Sharing Plan in accordance with its terms when: (1) they allowed the trust fund to be used for purposes other than for the exclusive benefit of the participants and (2) when they failed to distribute the assets of the Profit Sharing Trust upon the termination[6] of the Plan. The express contractual provisions of the Profit Sharing Plan had provided:

> The plan may be wholly or partially amended, . . . provided, however, that no such modification or amendment shall permit any part of the trust fund, . . . to be used for, or diverted to, purposes other than for the exclusive benefit of the Participants, their beneficiaries, or their estates, . . . Profit Sharing Plan, § 8.2.

According to the Class, this section of the Profit Sharing Plan was violated when the trustees allowed profit sharing assets to be placed into a Pension Plan which would permit earnings to benefit the employer and new employees.

The defendants deny that their actions violated ERISA for five reasons. *First*, the defendants deny that they violated any fiduciary duty owed under the former profit sharing plan because the profit sharing participants were given full credit for their principal and earnings as of March 31, 1975. *Second*, the defendants assert that even under employee contribution Pension Plans, ERISA requires only 5% earnings on employee contributions. Consequently, if 5% is all ERISA requires for a contributory plan, the defendants reason that the same guarantee must be adequate under a more generous non-contributory plan such as the one found at Velsicol.[7] *Third*, defendants argue that the excess earnings are not being used for Velsicol's benefit because those earnings are always channeled back into the fund for the *exclusive benefit* of plan

participants.[8] The defendants claim that the mere fact that Velsicol's contributions are reduced is immaterial. *Fourth*, the defendants contend the plan is lawful because the IRS approved the plan as a valid plan which satisfied all ERISA requirements.[9] *Finally*, the defendants contend that the former profit sharing participants never acquired a vested property interest in the profit sharing plan and therefore are not entitled to complain about the shifting of those assets into a Pension Plan.[10]

DISCUSSION

A. Summary Judgment Standards

Summary judgment is appropriate where there is no genuine issue as to any material fact, and the moving party is entitled to judgment in its factor as a matter of law. *Cedillo v. International Association of Bridge & Structural Iron Workers, Local Union No. 1*, 603 F.2d 7, 10 (7th Cir. 1979). Where, as here, cross-motions for summary judgment are filed, the court is not to assume that there are no issues of material fact, but instead make an independent determination based on the affidavits and other proof submitted by the parties in support of their respective motions. 10 Wright and Miller, *Federal Practice and Procedure* § 2720 (1973). *See Case and Co., Inc. v. Board of Trade of City of Chicago*, 523 F.2d 355, 360 (7th Cir. 1975). Upon examination of the depositions, affidavits and documents submitted by the parties, this court concludes that there are no material issues in dispute and that judgment may be rendered as a matter of law.

B. ERISA's Purpose and Terms

Proper interpretation of ERISA must begin with consideration of ERISA's purpose and intent.

ERISA is a comprehensive remedial statute primarily designed to protect individual pension rights. H.R.Rep. No. 533, 93d Cong., 2d Sess. 3, *reprinted in* [1974] U.S. Code Cong. & Admin. News, pp. 4639; *Freund v. Marshall & Ilsley Bank*, 485 F.Supp. 629, 634 (W.D. Wisc. 1979). The statute resulted from a growing concern that many employees were losing anticipated retirement benefits due to the lack of vesting provisions in such plans, the inadequacy of current minimum standards and the instability of plans to pay promised benefits. Thus, Congress passed the Act with the express purpose of protecting the interests of participants and preserving the integrity of plan assets. *Nachmann v. PBGC*, 446 U.S. 359, 361-1 & n.1, 100 S.Ct. 1723, 1726-27, 64 L.Ed.2d 354 (1980).

ERISA applies to any "employee benefit plan", 29 U.S.C. § 1003, and it took effect on January 1, 1975, 29 U.S.C. § 1052. Consequently, administration of the profit sharing plan during the period from January 1, 1975 to March 31, 1975 was governed by ERISA standards. All administration of the Pension Plan, which originated after January 1, 1975, is also within ERISA's parameters.

In order to prevent conflicts of interest and prevent actual or potential misuse of funds, ERISA has established strict precepts of minimum fiduciary conduct for pension plan trustees and administrators. 29 U.S.C. §§ 1101-1114; H.R.Rep. No. 533, *supra*, at 4655; S.Rep. No. 127, 93d Cong., 2d Sess. 3, *reprinted in* [1974] U.S. Code Cong. & Admin. News, pp. 4838, 4839. The Act imposes a central and fundamental obligation on fiduciaries which mandates that pension funds must be used for the exclusive benefit of plan participants and their beneficiaries. The sections of ERISA upon which plaintiff relies reflect this primary standard of fiduciary responsibility.

Section 404(a)(1)(A) of ERISA, 29 U.S.C. § 1104(a)(1) unequivocally establishes this duty, providing that:

> a fiduciary shall discharge his duties with respect to a plan *solely in the interest of the participants* and beneficiaries *and*—

A) *for the exclusive purpose of:*

(i) *providing benefits to participants* and their beneficiaries; . . . . (Emphasis added).

The obvious corollary to this primary fiduciary responsibility is stated in Section 403(c)(1), 19 U.S.C. § 1103(c)(1) which states that "*the assets of a plan shall never inure to the benefit of any employer.*"

Section 1106 supplements these fundamental standards by expressly prohibiting specific transactions and "imposing on parties in interest who are fiduciaries a duty of undivided loyalty to the plans for which they act." 29 C.F.R. § 2250.408b-2(e)1. Section 406(a)(1)(D) of ERISA, 29 U.S.C. § 1106(a)(1)(D) requires that:

> (1) *A fiduciary* with respect to a plan *shall not cause the plan to engage in a transaction, if he knows* or should know that *such transaction constitutes a direct or indirect*— . . .
>
> (D) transfer to, or *use by or for the benefit of, a party in interest, of any assets of the plan*; . . . . (Emphasis added).

And finally, Section 1104(a)(1)(D) gives the basic assurance that trustees will administer the plan in accordance with the plan's terms.

These provisions embody a carefully tailored law of trusts which imposes a primary requirement upon trustees to discharge their duties solely in the interest of the participants. The specific goal of each of these sections is to guarantee that the assets of an ERISA plan are used exclusively for the benefit of plan participants. ERISA should be given broad construction in order to fulfill its purpose of protecting the interests of plan participants and beneficiaries and preserving the integrity of plan assets. *Freund v. Marshall & Ilsley Bank*, 485 F.Supp. at 634. It is within this context that we must examine the defendants' actions regarding the earnings from the Profit Sharing Trust.

C. The Conversion of the Profit Sharing Plan Undisputedly Benefitted the Employer and Non Class Members

When the Profit Sharing Plan was converted to the Pension Plan, Velsicol provided that *all* earnings from the Profit Sharing Fund would stay in the Pension Plan. However, Velsicol provided that *only* 5% of the interest earned would inure to the Class Members. As a result, any excess profits beyond the "guaranteed" 5% must be viewed as funding the pensions of all Velsicol employees, including those new employees who did not participate in the Profit Sharing Plan. Consequently, whether it be deemed direct or indirect, Velsicol benefitted through reduced plan contributions only because Class Members were not given the full amount earned on their principal which had been carried over from the Profit Sharing Plan.

This fundamental fact, that class members did not receive the *full* amount of interest earned on their profit sharing interests, causes the plan to run afoul of ERISA's protective provisions.

It means that the funds were not used solely for the benefit of the plan participants (a violation of Section 404(a)1(A)(i)); but instead were used for the benefit of the employer (a violation of Section 403(c)1), 19 U.S.C. §1103(c)(1)). It also means that the funds were used in a fashion which raises an inherent conflict of interest between the employer and former profit sharing participants (a violation of Section 406(a)(1)(D), 29 U.S.C. § 1106(a)(1)(D)).

The conversion also violated the Profit Sharing Plan's specific provisions. Section 8.2 of the Profit Sharing Plan specifically prohibited any modification in the plan which would cause "any part of the trust fund . . . to be used for, or diverted to, purposes other than for the exclusive benefit of the participants." Here, the interest earned, a part of the trust fund, was placed into a pension plan in such a fashion that any earnings accrued over 5% would not benefit the participants, but instead would benefit the employer and non-participant employees. This transfer

violates Section 8.2 and, therefore, is also a violation of Section 404(a)(1)(D), which requires adherence to plan provisions.

D. Defenses

The five defenses to liability asserted by the defendants are without merit.

First, the defendants argue that profit sharing participants were given full credit for their principal and earnings as of March 31, 1975. This is true. But the liability flows from failing to give the Profit Sharing Plan participants full credit for earnings accruing after March 31, 1975. It is the post-March 31, 1975 earnings which are at issue.

Second, the defendants assert that ERISA only requires 5% earnings on contributory pension plans, *see* 29 U.S.C. § 1054(c)(2)(C); thus, 5% earnings must be reasonable on a more generous, non-contributory plan. The reasonableness of the return is not at issue. A 15% return would certainly be reasonable, but if 20% was earned on vested Profit Sharing Funds, ERISA and the profit sharing agreement mandate that participants receives those full earnings.

Third, it is true that all earnings are applied to the direct benefit of the Pension Plan participants. No funds are taken out of the fund or shifted to the employer. Consequently, it can be said that, in a manner of speaking, the funds do exclusively benefit Pension Plan participants. This argument, however, tends to place form over substance; the *indirect* benefit to the employer is clear. Moreover, earnings that should inure solely to the benefit of the former Profit Sharing Plan participants now benefit other new employees who have no interest in the profit sharing principal.

Fourth, IRS approval of the Pension Plan does not bar court review. Consequently, IRS' approval of the plan is not a defense to this kind of action.

Finally, defendants' argument that employee interests in the Profit Sharing Plan never vested is unpersuasive. It is true that Section 8.3 of the Profit Sharing Plan allowed for *termination* of the plan upon board of director resolution, dissolving of Velsicol, or merger. That the means for terminating the plan existed does not establish that upon a termination the Company would not be obligated to distribute the profit sharing interests already accrued. Nothing in Section 8.3 addresses vesting. Velsicol's own actions, in attempting to accommodate the profit sharing interests and in giving full credit for profit sharing principal and earnings as of March 31, 1975, belies their contention that employees never had a vested interest in the plan.

For these reasons, the court enters partial summary judgment in favor of the plaintiffs and against the defendants on the issue of liability. A pre-trial conference is hereby set for October 12, 1983 at ____ A.M., at which time the court will discuss with the parties how the damages portion of the suit will be handled.

It is so ordered.

ENTER:

/s/ Stanley J. Roszkowski
Judge
United States District Court

Dated: October 4, 1983

FOOTNOTES

[1] The annual earnings fluctuated from 20.55% gain in 1971 to a 19.44% loss in 1974.

[2] A participant's "initial distribution" date was determined by one of the following events:

a) normal retirement at age sixty-five;

b) retirement, with consent of the employer, at age fifty-five;

c) retirement at any time after December 31, 1975 due to total and permanent disability;

d) death;

e) termination of employment for any other reason.

[3] There is some dispute among the parties as to whether the defendants actions should be characterized as a conversation of the Profit Sharing Plan to a Pension Plan or whether the actions can be characterized as a termination of the Profit Sharing Plan with the newly created Pension Plan introduced as a replacement. All parties, however, agree on the events that transpired; only the legal significance of those events is in dispute.

[4] The Pension Fund Trust had returns as follows:

1975	+25%
1976	+ 7%
1977	(55/100 of 1%)
1978	+ 9.4%
1979	+13.7%
1980	+19.6%
1981	+ 6.7%

[5] Velsicol's average annual contribution to the Profit Sharing Plan during the seven years prior to the conversion was $409,334. Velsicol's contributions to the Pension Plan during the seven years subsequent to the conversion were as follows:

1975	$490,595
1976	$452,149
1977	$302,370
1978	$403,393
1979	$531,608
1980	-0-
1981	-0-

[6] The class offers several arguments to support their contention that the Profit Sharing Plan was in effect terminated:

1) the marked difference between a Profit Sharing and Pension Plan; the Class stresses that the two are completely different entities—conceptually, mechanically and legally.

2) the Profit Sharing Plan ceased to function and defendants refer to it as the "Former Plan."

3) the Treasury Regulations, in the context of conversion of plans from one corporation to another, define the termination of a qualified plan and provides that:

> Thus, *a profit sharing plan . . .* established by the transferor or distributor corporation *shall*, for purposes of subparagraphs (2) and (3) of this paragraph, *be considered terminated if*, after the date of distribution or transfer, *the acquiring corporation transfers the funds accumulated under the profit-sharing plan into a pension plan covering the same employees.*

26 C.F.R. § 1.381(c)(11)-1(d)(4) (Emphasis added).

4) the defendants fully vested the rights of all participants in the Profit Sharing Plan as they were required to do so when the plan is terminated, 26 U.S.C. § 411(d)(3)(A), or upon complete discontinuance of contributions under the plan. 26 U.S.C. § 411(d)(3)(B).

[7] This assertion, that ERISA does not mandate specific interest rates for employer contributions, is based upon the defendants' own interpretation of ERISA. The defendants stated that, "[h]aving specifically covered employee contributions, it must be assumed that ERISA would have mandated earnings on employer contributions if Congress had intended the Act to do so." (Defendants' Brief 14).

[8] The investment income is returned to the Pension Trust minus expenses for administration of the Pension Plan allowed by ERISA.

[9] The favorable determination letter from the IRS was issued after the Service had reviewed the written Pension Plan document and supporting information submitted by Velsicol.

[10] Velsicol contends the profit sharing interests were not vested because the plan could be terminated under certain circumstances. Section 8.3 of the Profit Sharing Plan provides that the plan may be terminated (1) by resolution of the board of directors of Velsicol specifying such termination; (2) if the company is judicially declared bankrupt, insolvent or is dissolved; or (3) if the company undergoes a merger, consolidation, reorganization or sale of all or substantially all of its assets.

STATUTES INVOLVED

29 U.S.C. § 1104(a)(1)(A)

§ 1104. Fiduciary duties

(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; * * *

29 U.S.C. § 1106(a)(1)(D)

§ 1106. Prohibited transactions

(a) Transactions between plan and party in interest

Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transactions constitutes a direct or indirect—

* * *

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan;

29 U.S.C. § 1104(a)(1)(D)

§ 1104. Fiduciary duties

(a) Prudent man standard of care

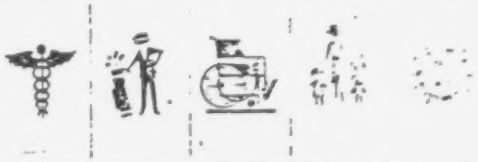
(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

* * *

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter or subchapter III of this chapter.

MR. ROBERT C NICKERSON
X S 109 BIG HORN UNIT
WHEATING ILL
66397

About this Report



About You

Survivor's Protection

Lump-Sum Payments

COMPANY LIFE INSURANCE..... 150.00C

SOCIAL SECURITY..... 0295

YOUR BENEFICIARY WILL ALSO RECEIVE YOUR PRIOR PROFIT SHARING BALANCE OF..... 033.338

IN ADDITION, IF YOUR DEATH IS THE RESULT OF AN ACCIDENT AND OCCURS WITHIN 90 DAYS OF IT, YOUR BENEFICIARY WILL RECEIVE..... 050.000

IF YOU ARE ACCIDENTALLY KILLED WHILE TRAVELING ON CERTAIN COMPANY BUSINESS ASSIGNMENTS, YOUR BENEFICIARY WILL RECEIVE AN ADDITIONAL..... 050.000

YOU MAY WISH TO CHECK TO SEE IF YOUR BENEFICIARY DESIGNATIONS ARE UP TO DATE.

Monthly Payments

Spouse and 1 Child	Spouse and 2 Children (Present Dependents)	Spouse Only or Age 65
0357	0788	0329

Health Care

YOU AND EACH OF YOUR ELIGIBLE DEPENDENTS ARE COVERED BY OUR MEDICAL PLAN.

YOU PAY THE FIRST 050 OF EXPENSES (MAXIMUM OF 0150 PER FAMILY) EACH CALENDAR YEAR PER PERSON COVERED.

THEN, THE PLAN PAYS 85% OF THE REMAINING EXPENSES SUCH AS HOSPITAL, SURGICAL, MEDICAL AND PRESCRIPTION DRUG EXPENSES. PREVENTIVE (INCLUDING PHYSICAL EXAMS) AND DIAGNOSTIC, AS WELL AS OTHER COVERED CHARGES. IN EMERGENCY MEDICAL NEEDS, UP TO ONE YEAR. THE PLAN PAYS 100% OF EXPENSES IN EXCESS OF 3500.

[illegible] ARE THE SAME AS 1977 EXCEPT AS NOTED.

The maximum lifetime benefit per person of 0150,000 is redetermined annually at a rate of 15% per year. This may be increased upon evidence of good health.

Covered charges include physicians' fees, private duty nurses, room, miscellaneous services, medicines, ambulance, X-rays, certain ante-surgical procedures, and laboratory services, and treatment.

Medical expenses for work-related illness or injury normally will be covered by Workmen's Compensation.

Retirement

The Company bears the entire cost of your pension. A basic plan Social Security forms for the basis of the amount you pay.

Your normal retirement date (age 65) is 04/01/1993
On that date, you can accumulate 42 years and 8 months of creditable service.

If you continue to work for the Company until your normal retirement date, using your present pay, your monthly retirement benefit provided for your lifetime (and could be payable jointly [illegible] 01,979.00
OF THIS AMOUNT 0340.07 WOULD BE FROM YOUR DEFERRED PROFIT-SHARING ACCOUNT, 0221.39 FROM OUR PENSION PLAN AND 0916 FROM SOCIAL SECURITY.

YOU COULD HAVE TO SAVE 0110.151 OF AGE 65 IN ORDER TO HAVE THE SAME MONTHLY RETIREMENT INCOME AS OUR PLAN PROVIDES.

In addition to your own Social Security benefit, a wife or dependent husband may be eligible for an additional benefit equal to as much as 50% of yours. The percentage depends on his or her age. If your spouse has been employed, he or she may be entitled to an even larger benefit based on his or her own account.

AS OF 1/1/77 YOU HAVE A VESTED RIGHT TO A MONTHLY BENEFIT OF 0505.00 UPON REACHING AGE 65. OF THIS AMOUNT, 0340.07 A MONTH WOULD BE FROM YOUR DEFERRED PROFIT-SHARING ACCOUNT BALANCE. YOUR PRIOR PLAN BALANCE IS 033.338.

Holidays & Vacations

During the calendar year 1977 the company observes 10 paid holidays.

YOU WILL EARN 3 WEEKS OF PAID VACATION THIS CALENDAR YEAR.

*Other terms of payment may be selected that provide continuing income to your surviving beneficiary. See your personal counselor for details.

If you are ill or Disabled

If an illness or injury keeps you from work, you may be paid for up to 12 accumulated sick days per year after one year of service.

YOU OTHER BENEFITS INCLUDE WORKERS' COMPENSATION, PAYMENTS TO WHICH YOU ARE ENTITLED.

After 26 weeks, you may be eligible to receive 50.33[illegible] per month until [illegible] This amount will include any Social Security and workers' compensation benefits to which you are entitled.

In addition, after you are totally disabled, your group life insurance may continue in force and after 9 months you may be exempted from [illegible] See your booklet for details.

Value of this Program to You

The value of your benefit program adds significantly to the pay you receive.

The Company's cost for your benefits in 1977 will be approximately 06,957.

These benefits include insurance, holidays and other time you were paid but did not work, group insurance, retirement benefits, Workmen's Compensation, unemployment insurance, and Social Security taxes (you pay an equal amount).

And these dollars are worth much more to you than if they were added to your paycheck (1) they are not taxable income for you (2) they are more valuable because of group coverage and (3) they provide protection that many employees would not qualify for as individuals.

ADDITIONAL BENEFITS AVAILABLE BUT NOT INCLUDED IN THESE COSTS ARE THE EDUCATIONAL ASSISTANCE PROGRAM, JURY DUTY ALLOWANCE, FUNERAL PAY, MILITARY DUTY ALLOWANCE, AND RELIANT PARKING AND FOOD SERVICE FACILITIES WHERE PROVIDED.

GROUP EXHIBIT 5
(Reduced Copy)

BEST AVAILABLE COPY

BEST AVAILABLE COPY

Your date of birth: 3/10/23
Your date of employment: 9/01/50

YOUR PENSION PLAN

RETIREMENT:

Your Normal Retirement Date under the Velsicol Chemical Corporation Pension Plan is 4/01/93 Subject to the terms and conditions of the Plan you will then be eligible to retire and receive an estimated monthly income for life under the Pension Plan as follows:

$	473	Estimated Monthly Income provided by your prior profit sharing balance accumulated with interest to Normal Retirement;
	507	Estimated Monthly Income provided by the Pension Plan at Normal Retirement;
$	980	Total Estimated Monthly Plan Benefit;
	424	Plus an Estimated Social Security Benefit;
$	1,404	Total Estimated Monthly Retirement Income, or 66% of your Monthly Compensation.

At retirement you will be accorded the option of receiving the profit sharing portion of your benefit in a lump sum, with a corresponding actuarial reduction in your monthly benefit.

DEATH PRIOR TO RETIREMENT:

If you should die prior to retirement, your beneficiary will be entitled to a death benefit equal to your prior Profit Sharing balance accumulated with interest to your date of death. As of 3/31/75 your accumulated prior Profit Sharing balance is $ 30,465.

In addition, if you are survived by a spouse and/or children, they may be entitled to a Monthly Income from Social Security. The amount of Income will depend upon the ages of your survivors and your Social Security earnings history.

7
808

VELSICOL CHEMICAL CORPORATION

PENSION PLAN BENEFIT STATEMENT

Prepared especially for ROBERT C HICKERSON
409-44-4383

EXHIBIT 6

As of AS OF APRIL 1, 1975

8.2—AMENDMENT OF THE PLAN

The plan may be wholly or partially amended, or otherwise modified, at any time by resolution of the Board of Directors of the Company, which shall be ratified and adopted by like resolutions of each of its included subsidiaries, provided, however, that no such modification or amendment shall permit any part of the trust fund, other than such part as is required to be disbursed in order to meet expenses involved in its administration to the extent not paid by the Company, to be used for, or diverted to, purposes other than for the exclusive benefit of the Participants, their beneficiaries, or their estates, and provided further, that no such modification or amendment shall operate to reduce or eliminate the account of any person or persons acquired prior to the effective date of such modification or amendment, except modifications or amendments which are necessary to establish or maintain, without interruption, the qualification of the trust for tax exemption under the Internal Revenue Code (as amended from time to time) and the regulations promulgated thereunder.

Supreme Court, U.S.
FILED
JUL 1 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1796

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

ROBERT C. HICKERSON, on his own behalf and on behalf of all others similarly situated,
Petitioner,
v.

VELSICOL CHEMICAL CORPORATION, a Delaware corporation; THE NORTHERN TRUST COMPANY, an Illinois banking corporation, as Trustee of the Velsicol Chemical Corporation Pension Plan; BEN W. HEINEMAN; PAUL J. WEIR; BERNARD FIRESTONE; ROBERT R. GARRISON; and THE RETIREMENT COMMITTEE OF THE VELSICOL CHEMICAL CORPORATION PENSION PLAN,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF IN OPPOSITION FOR RESPONDENTS

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QUESTIONS PRESENTED FOR REVIEW

I.

Is it appropriate for petitioners to raise new fact issues in this Court, on a subject that the Seventh Circuit has remanded to the district court for further proceedings?

II.

Does ERISA permit conversion of a defined contribution plan to a defined benefit plan where accrued benefits of participiants are preserved?

III.

Where such conversions are expressly authorized under ERISA, should common law trust principles be applied without regard to the Congressional purpose and comprehensive regulatory scheme expressed in ERISA?

IV.

Did the Seventh Circuit create a "reasonableness" exception to ERISA's prohibited transactions section?

V.

Did the Seventh Circuit correctly identify the nature of plan participants' ownership interests with reference to their accrued benefits rather than to the physical assets of the plan?

STATEMENT UNDER RULE 28.1

Velsicol Chemical Corporation is wholly-owned by Farley/Northwest Subsidiary Corporation, which is in turn wholly-owned by Farley/Northwest Industries, Inc. Farley/Northwest Industries, Inc. is at least 80% controlled by Farley/Northwest Holding Company, which is in turn at least 80% controlled by Farley Metals, Inc. Farley Metals, Inc. is privately owned, and controlled by William Farley. Affiliates of Velsicol Chemical Corporation are Farley Metals International, Inc., which is wholly-owned by Farley Metals, Inc.; Union Underwear Company, which is wholly-owned by Farley/Northwest Industries, Inc.; Acme Boot Company, which is wholly-owned by Farley/Northwest Industries, Inc.; Northwest Leasing Company, which is wholly-owned by Farley/Northwest Industries, Inc.; General Battery Corporation, which is wholly-owned by Northwest Leasing Company; Farley Acquisition Company, which is approximately 95% owned by William Farley; Condec Corporation, which is approximately 95% owned by Farley Acquisition Company; NRM Corporation, which is wholly-owned by Condec Corporation; Consolidated Controls Corporation, which is at least 90% owned by Condec Corporation; Lima Electric, which is wholly-owned by Condec Corporation; Farley Energy Corporation, which is 100% owned by William Farley; Coal Creek Mining Company, which is wholly-owned by Farley Energy Corporation; Clayts Coal Sales, Inc., which is wholly-owned by Farley Energy Corporation; Anaheim Citrus Products, which is 100% owned by William Farley; Farley Industries, Inc., which is 100% owned by William Farley; and Farley Investment Company, which is 100% owned by William Farley.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1796

ROBERT C. HICKERSON, on his own behalf and on behalf of all others similarly situated,

Petitioner,

v.

VELSICOL CHEMICAL CORPORATION, a Delaware corporation; THE NORTHERN TRUST COMPANY, an Illinois banking corporation, as Trustee of the Velsicol Chemical Corporation Pension Plan; BEN W. HEINEMAN; PAUL J. WEIR; BERNARD FIRESTONE; ROBERT R. GARRISON; and THE RETIREMENT COMMITTEE OF THE VELSICOL CHEMICAL CORPORATION PENSION PLAN,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF IN OPPOSITION FOR RESPONDENTS

Respondents Velsicol Chemical Corporation, et al., submit this brief in opposition to the petition for writ of certiorari filed by Robert C. Hickerson.

STATEMENT OF THE CASE

Establishment of the Velsicol Plan

Velsicol established its retirement Plan in 1956 as a defined contribution profit sharing plan for eligible salaried employees. Under the Plan, Velsicol had the discretion to contribute between two percent and ten percent of its consolidated net profits for any given year (not to exceed the maximum amount deductible under Section 404(a) of the Internal Revenue Code of 1954, as amended). Amounts contributed to the Plan in any year thus depended upon the level of Velsicol's profits and the percentage of those profits Velsicol's management elected to contribute. The employees made no contributions to the Plan.

The amount of Velsicol's contribution for each year was credited to individual book accounts maintained for each participating salaried employee. The assets held in the Plan's trust fund were not earmarked for particular participants, but were maintained in a common pool for the benefit of a changing class consisting of those employees who were, from time to time, eligible to be participants of the Plan. The participants' accounts were periodically adjusted to reflect investment gains and losses experienced by the Plan's trust fund. Thus, for any given year, a participant's account might increase, decrease, or remain the same. Plan participants assumed not only the risk of Velsicol's profitability, which would affect the amount of Velsicol's contribution to the fund in any year, but also the risk of investment gains and losses with respect to the assets already in the fund. In any year in which investment losses exceeded Velsicol's contribution, participants' account balances would decrease.

Because the Plan was a defined contribution plan, no specific retirement benefit was guaranteed to Plan participants. Instead participants received whatever level of benefits were provided by their account balances at retirement. The Plan provided that the amount of a partici-

pant's account balance at retirement would be paid in one or a combination of the following ways, as determined in the sole discretion of the Plan's trustees.

(1) periodic installments over a period of up to 10 years, with the amount of each installment to be based upon the participant's account balance at retirement, plus simple interest fixed at the rate paid on saving accounts by the bank serving as custodian of the Plan's trust fund (5% annually at the time of the Plan amendment),[1] but without adjustment for post-retirement investment gains or losses, divided by the number of installments;

(2) by the purchase with such money of an annuity contract; or

(3) a single lump sum payment of such amount.

Under the Plan, participants' rights to such benefits became nonforfeitable *pro rata* over a 10-year period so that any employee who left Velsicol before completing ten years of service forfeited a portion of his account balance.

While Velsicol expected to continue the Plan indefinitely, it reserved the right to discontinue contributions to the Plan. Furthermore, the Plan provided that it could be wholly or partially amended, or otherwise modified, at any time.

Pre-1975 Investment Experience of the Plan

During the 18-year period from the time the Plan was established in 1956 until it was amended in 1975, the trust fund's investment earnings averaged 5.7% per year. Annual investment performance experienced great fluctuations, however. In 1971 investment gains were 20.55%. However, in the two years prior to amendment, the trust funds suffered losses—7.71% in 1973 and 19.44% in

[1] The maximum amount payable by banks on savings accounts under 12 C.F.R. § 217.7(c).

1974. Those losses reduced the account balances of all Plan participants and *permanently* reduced the retirement benefits of participants who terminated employment in 1973 and 1974.

Velsicol's Decision to Convert the Plan from a Profit Sharing Plan into a Pension Plan

Faced with the uncertainties and fluctuations in participants' account balances under the profit sharing plan structure, Velsicol management concluded that conversion of the Plan into a defined benefit pension plan would be in the best interest of Velsicol's employees. In a letter to Velsicol's employees dated March 28, 1975, Robert Morris, then President of Velsicol, explained the situation as follows:

> "As you can see, although Velsicol's dollar contribution from profits was the highest in our Company's history, the decline in stock market prices reduced our trust fund balance by over 19%. Although, thanks to careful management of our profit sharing fund investments, our fund performed better than the Dow Jones and Standard and Poor's indexes, the net result was still an overall decrease in employee account balances. And, unfortunately, this is the second year in a row that the stock market has offset most or all of Velsicol's largest profit contributions. One of the primary purposes of our Deferred Profit Sharing Plan was to enable participants to build-up sizeable nest eggs during their working years to provide retirement benefits and security at age 65. However, adverse fluctuations in company profits and stock market valuations over the past six months have repeatedly demonstrated that a profit sharing plan does not provide the dependable financial security and long range income assurance which employees require in retirement.
>
> To provide you with better security after retirement, I am pleased to announce that the present Deferred Profit Sharing Plan will be converted to and replaced

by a Pension Plan effective April 1, 1975. You and all other present profit sharing plan participants (except for certain international employees) will automatically become participants in the new pension plan as of that date."

Adoption of the Defined Benefit Pension Plan Structure by Velsicol

Under the "defined benefit" pension plan structure adopted by Velsicol, the benefits to be paid to participants are fixed as defined in the Plan—*i.e.*, dollars per month for life beginning at retirement. Annual contributions are made to the Plan by Velsicol in amounts computed by the Plan actuary so that the Plan's trust fund will have sufficient assets to provide those fixed benefits when they become payable. In contrast to the profit sharing plan structure, all investment risk under the Plan after its conversion into a pension plan is borne by Velsicol. Any investment losses increase the amount of Velsicol's contributions to the Plan, while investment gains reduce Velsicol's contributions. Investment gains or losses in the trust fund become irrelevant to the employees because they are guaranteed fixed benefits regardless of investment results.

This shifting of investment risk to Velsicol was obviously important to retiring employees whose retirement income was fixed under the profit sharing plan structure based upon their Plan account balances at the end of their year of retirement. These employees were particularly vulnerable to short term fluctuations in the Plan's investment performance. A harsh example of this vulnerability occurred just prior to the Plan amendment. Velsicol employees who retired in 1974 saw their retirement benefits cut by almost 20% from the amounts which they had expected to receive just a few months earlier.

Upon the conversion of the Plan into a pension plan, the discretionary nature of Velsicol's contributions ended,

and the risk of investment losses was transferred from the Plan participants to Velsicol. Velsicol became obligated to comply with the funding standards of Sections 302-306 of ERISA, 29 U.S.C. §§ 1052-1056, and Section 412 of the Code [2] and took upon itself the considerable potential liability under Section 4062 of ERISA to pay benefits if the Plan were ever terminated.

Under the Plan as amended, participants became entitled to a "defined benefit" at retirement. For each year of qualified service, up to a maximum of 25 years, a participant became entitled to a total retirement benefit [3] equal to 2% of his average compensation for the highest 5 consecutive years out of his last 10 years of employment. An employee qualifying for the maximum benefits under this formula would thus receive retirement income equal to 50% of his final average pre-retirement income.[4] Following amendment of the Plan, Velsicol requested a determination from the Internal Revenue Service that the amended Plan was in full compliance with the re-

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[2] The sections of ERISA referred to in this brief are the provisions of Title I and Title IV of ERISA, which are applicable to all defined benefit pension plans. The sections of the Code cited herein apply to tax-qualified plans such as the Velsicol Plan, which are subject to both the provisions of the Code and to the non-tax provisions of ERISA. Title II of ERISA amended many provisions of the Code applicable to tax-qualified plans; however, only the Code citation is provided for these provisions.

[3] Including a calculated portion of his social security benefit, according to the concept, customary in such plans, that the employer has provided, through the social sequrity tax imposed on employers, a portion of the social security benefit, which is part of the employee's total retirement income.

[4] As social security benefits were nontaxable and the balance of the total retirement benefit would normally be taxed at lower rates post-retirement (as the employee's total income normally falls after retirement), the practical result is to leave the employee with somthing more than 50% of his pre-retirement income on which to live.

quirements of Section 401 of the Code. The Internal Revenue Service issued a ruling to this effect on November 21, 1977.

Treatment of the Profit Sharing Account Balances

Prior to the conversion of the Plan into a pension plan on April 1, 1975, every participant with fewer than ten years of service would have forfeited a portion of his Plan benefits under termination of employment. As a part of the conversion, the claim of every participant, regardless of length of service, to his full Plan benefits became nonforfeitable. In addition, the Plan guarantees that the portion of participants' minimum benefits based on their account balances will increase at a rate of 5% compounded annually, without regard to the actual investment gain or loss of the trust fund. As of April 1, 1975, when this guarantee was put into effect, and as of today, there was, and remains, no way of knowing whether actual investment results between the date of the Plan amendment and the termination of the profit sharing participants' career with Velsicol will be less than, equal to, or in excess of the 5% guarantee. The investment risk was shifted from the Plan participants to Velsicol.

As it happened, the investment experience of the trust fund from the date of conversion to the present has been positive. From 1975 through 1981, the average return received on the trust fund was 11.55% per year. Earnings on the fund continued to fluctuate greatly, however. In 1975 the return was 25%, while the return was less than one percent in 1977. These historically high investment earnings were accompanied, if not occasioned by, historically high inflation. To the extent that inflation causes participants' compensation to increase to correspondingly higher levels, the further result was an increase in the "defined benefit" payable at retirement. In this way, higher investment returns were reflected directly in higher pension benefits.

These investment gains did not go unnoticed by the plaintiffs. While they were aware of the conversion of the Plan into a pension plan at the time that it occurred, and were aware that the investment risk had been shifted from them to Velsicol, litigation was not instituted until 6 years after conversion from the profit sharing structure to the pension plan structure.

Petitioners have asserted that Velsicol "fully expected" that the investment performance of the fund would nearly double its profitability, and that this expectation was the principal motivation for the Plan conversion. (Petition, pp. 7-8). The evidence before the district court did not support this conclusion, and the petitioners did not urge it at the district court level. Instead, the petitioners' position in their summary judgment motion was that, assuming Velsicol's actions were motivated by concern for Plan participants, the conversion from a defined contribution to a defined benefit plan was not permitted under ERISA. Thus, the motivation issue was not before the district court and was not decided.

Proceedings Below

Petitioners' theory below was that Plan participants had physical ownership of the assets in the Plan, and that this asset ownership precluded conversion of the Plan to a defined benefit plan which did not continue to credit participants with all investment results of the fund. The district court accepted this theory, and granted summary judgment to the petitioners:

> "The reasonablness of the return is not at issue. A 15% return would certainly be reasonable, but if 20% was earned on vested Profit Sharing Funds, ERISA and the profit sharing agreement mandate that participants receive those full earnings." (Petition, 41a.)

The Seventh Circuit reversed, holding that the participants did not have an ownership interest in the Plan

assets that would preclude conversion, though the participants did have a vested interest in their profit sharing plan account balances. (Petition, 11a.) In reaching this result, the court noted that nothing in the Plan documents or in ERISA or in its implementing regulations conferred such an ownership interest. Rather, the nature of the rights conferred by the Plan documents and ERISA was to the value of the accounts at the date of conversion. (Petition, 11a-17a.) The fundamental error of the district court was not in its analysis of trust law principles, but in its unsupported assumption that the nature of the participants' ownership interests could be determined by analogy to trust law principles rather than by reference to the Plan documents and to ERISA.

The Seventh Circuit held, however, that the reasonableness of the 5% guaranteed rate of return on the participants' account balances could not be determined on the record before the court, and remanded the case to the district court for further proceedings on this issue. Thus, the case has not yet reached final judgment disposing of all issues, and will not until after the proceedings are concluded on remand.

SUMMARY OF ARGUMENT

The Seventh Circuit has held that it is permissible under ERISA to convert a defined contribution plan to a defined benefit plan so long as accrued benefits of plan participants are preserved. However, because the record below was not sufficiently complete to permit a comparison of the value of participants' accrued benefits before and after conversion, the case was remanded to the district court for further proceedings.

While these rulings are important to the administration of employee benefit plans, they are not reasonably subject to dispute. The closeness of the case, as acknowledged by the Seventh Circuit, lay in the reasonableness of the guaranteed rate of return selected by Velsicol at

the time of conversion, an issue which the court left for determination by the district court in further proceedings.

Contrary to petitioners' argument, the Seventh Circuit did not hold that petitioners would have won under traditional trust law principles, but rather, that these principles were to be interpreted in the context of ERISA provisions expressly authorizing plan conversions. The Seventh Circuit did not create a reasonableness exception to ERISA's prohibited transactions section; it simply recognized that ERISA authorizes conversions that preserve the value of accrued benefits. Finally, the Seventh Circuit did not depart from established law in holding that participants did not own the physical assets in the profit-sharing trust fund. The plan documents, existing case law, and provisions of ERISA establish that participants owned their accrued benefits, not the plan assets.

ARGUMENT

Petitioners Cannot Raise New Fact Issues in This Court

Petitioners' theory below was that ERISA flatly prohibits conversion of a defined contribution plan to a defined benefit plan unless participants continue to bear the investment risk associated with the profit sharing plan assets. In their summary judgment motion, petitioners did not attack either the reasonableness of the 5% rate of return guaranteed by Velsicol or its motivation in converting the plan to a defined benefit mode, because these issues would necessarily have raised factual questions requiring a trial. Instead, petitioners pursued a *per se* violation theory which was adopted by the district court, but rejected by the Seventh Circuit. Petitioners now disingenuously argue that they should have prevailed below because Velsicol failed to prove by clear and convincing evidence the reasonableness of the 5% rate of return. (Petition p. 12) This was Velsicol's burden, petitioners assert, because Velsicol is a fiduciary and fiduciaries must justify their conduct.

Petitioners, however, cannot come to this Court seeking fact findings on issues not raised below, and concededly irrelevant to their theory of liability. If petitioners are asking this Court to adopt their *per se* violation theory, they must concede that neither reasonableness of the rate of return nor employer motivation is a relevant concern. Yet petitioners' argument is cast on the premise that the rate of return was unreasonable and that Velsicol sought to profit from the conversion. Neither the district court nor the Seventh Circuit held that Velsicol had any such motivation, nor that the rate of return was unreasonable. The Seventh Circuit did hold—contrary to petitioners' theory—that reasonableness of the rate of return is an issue which is relevant, but which must be decided on remand to the district court because the record was incomplete on this issue. The Seventh Circuit also ruled that determination of the reasonableness of the rate of return is to be made in light of economic conditions prevailing in 1975 when the conversion occurred, and not with the type of hindsight analysis offered by petitioners.

In reaching this result, the Seventh Circuit recognized that conversion of a defined contribution plan to a defined benefit plan is expressly contemplated under ERISA, and that it is not an act of self-dealing for employers to shift the investment risk associated with defined contribution plans from the employees to the employers in converting to a defined benefit plan so long as a reasonable rate of return is selected.

Traditional Trust Law Principles Cannot Be Applied Without Reference to ERISA

Petitioners are entirely correct that traditional trust law principles cannot blindly be applied without reference to ERISA. Contrary to petitioners' argument, the Seventh Circuit correctly discerned that ERISA leaves to employers flexibility to design and change employee benefit plans so long as accrued benefits are preserved.

This Court recognized this aspect of ERISA in *Alessi* v. *Raybestos-Manhattan*, 451 U.S. 504, 511-14 (1981):

> . . . what defines the content of the benefit that, once vested, cannot be forfeited? ERISA leaves this question largely to the private parties creating the plan. That the private parties, not the Government, control the level of benefits is clear from the statutory language defining nonforfeitable rights as well as from other portions of ERISA. ERISA defines a "nonforfeitable" pension benefit or right as "a claim obtained by a participant or his beneficiary to that part of an immediate or deferred benefit under a pension plan which arises from the participant's service, which is unconditional, and which is legally enforceable against the plan." 29 U.S.C. § 1992(19) . . . . Similarly, the statutory definition of "nonforfeitable" assures that an employee's claim to the protected benefit is legally enforceable, but it does not guarantee a particular amount or a method for calculating the amount. As we explained last Term, "it is the claim to the benefit, rather than the benefit itself, that must be "unconditional" and "legally enforceable against the plan" . . . .

The same principle has led courts to reject challenges to the decision-making processes of plan fiduciaries in *Salazar* v. *Sandia Corp.*, 656 F.2d 578 (10th Cir. 1981), and in *United Independent Flight Officers* v. *United Airlines*, 572 F.2d 1494 (N.D. Ill. 1983).

ERISA Permits Plan Conversions Where Accrued Benefits Are Preserved

The appropriate inquiry under ERISA is whether, upon conversion, accrued benefits of employees have been preserved. In order to satisfy this inquiry it is necessary first to determine what benefits are accrued at the time of conversion, and then to determine whether the new plan preserves those benefits. While this would seem so obvious as to be a truism, both the timing of the com-

parison and the nature of the accrued benefits to be compared presented difficulties to the district court because it confused the right to accrued benefits under a retirement plan with rights a trust beneficiary might have in circumstances involving a non-employment related common law trust, *e.g.*, a trust established by a father for his son.

At the time of conversion, the participants' accrued benefits consisted of the amounts of their account balances at retirement, to be paid at the discretion of the plan trustees, (a) in periodic installments over a period up to 10 years at 5% interest, (b) by the purchase of an annuity contract or (c) by a single lump sum payment. The Seventh Circuit held that the record below was not sufficiently complete to permit a comparison of the value of these accrued benefits with the total package of benefits that the participants were provided under the benefit plan after conversion. The reason that the record was incomplete was that the petitioners never addressed the issue of preservation of accrued benefits prospectively at the time of conversion. Instead, they focused upon the fact that, subsequent to conversion, the actual investment experience of the fund exceeded 5%. This approach enabled the petitioners to claim that there were excess earnings which belonged to the class members. However, the plan participants did not own the fund; they owned their rights to accrued benefits. So long as their accrued benefits were preserved in the context of the defined benefit plan, the investment performance of the fund following conversion was irrelevant to petitioners since they had no vested right to continue to participate in the investment performance of the fund in the future. ERISA does not require that, upon conversion of a profit-sharing plan to a defined benefit plan, the assets of the profit-sharing plan must continue to be segregated and held in trust solely for the benefit of the participants in the profit-sharing plan. The funding requirements of the defined

benefit plan are determined by actuarial computation of the accrued future liabilities of the plan, and the assets of the defined benefit plan are deemed available to pay benefits to all employees covered by the plan. The defined benefit structure is completely independent of the investment gains or losses on the assets of the defined benefit plan.

The Self-Dealing Prohibitions of ERISA Do Not Bar Incidental Benefit to Employees in the Context of a Permitted Conversion

Petitioners have also misread the prohibitions of ERISA against self-dealing when applied to conversion of a defined contribution plan to a defined benefit plan. The language of ERISA stating that "the assets of a plan shall never inure to the benefit of any employer" cannot be read as a prohibition against decisions of an employer with respect to a pension plan which have the primary purpose and effect of benefiting the employees, and in addition the incidental side effect of being prudent from the employer's economic perspective. *Holliday* v. *Xerox Corp.*, 732 F.2d 548, 551 (6th Cir. 1984). Petitioners' self-dealing argument is focused entirely upon the assumed benefit to Velsicol that flowed from the fact that investment gains exceeded 5%, on average, in the years following conversion. The issue is not whether the employer may have realized some incidental benefit from a plan conversion or amendment, but instead, whether accrued benefits of employees are preserved. As the court noted in *Holliday*, Congress did not intend ERISA to penalize employers for exercising their discretion to make rational economic decisions which are both in the best interest of the preservation of the fund and are also not adverse to the employer's interest. (732 F.2d at 552).

The Seventh Circuit Did Not Create a Reasonableness Exception to the Prohibited Transaction Section of ERISA

Nor has the Seventh Circuit created a reasonableness exception to the prohibited transaction section of ERISA, as petitioners argue. The Seventh Circuit held that an accrued benefit consisting of a participant's account ballance in a profit-sharing plan is preserved upon conversion to a defined benefit plan if the participant is guaranteed a reasonable rate of return on his account balance or if the total package of benefits provided to the participant equals or exceeds that account balance. The fallacy of petitioners' argument lies in their failure to focus upon the requirement in ERISA that accrued benefits be preserved at the time of conversion. Again, petitioners have attempted to apply common law trust principles without recognizing the interrelationship among the various provisions of ERISA. The prohibited transaction section cannot be read independently of those sections of ERISA which permit conversion so long as accrued benefits are preserved.

Plan Participants Owned Their Accrued Benefits, Not the Plan Assets

The only effort made by participants to focus on the accrued benefit issue is their assertion that the plan participants had ownership of the physical assets of the profit-sharing plan, and thus, indefeasible rights to all future earnings from those assets. (Petition pps, 20-26). Petitioners argue that the Seventh Circuit departed from existing law in rejecting their theory, but the petition cites no law except for an ambiguous *dictum* in a Fifth Circuit decision comparing the allocation of investment earnings in a profit-sharing plan to the receipt of interest on a bank account. *Dennard* v. *The Richards Group, Inc.*, 681 F.2d 306, 310 (5th Cir. 1982). While the Seventh Circuit acknowledged that there was relatively little

authority on this issue, it correctly concluded that the most relevant cases suggested that participants have only a right to the value of their accounts determined as of the date of conversion. (Petition, 12a, citing *Bianchan* v. *McGraw-Edison Co.*, 438 F. Supp. 585, 588 (W.D. Pa. 1976), *aff'd mem.*, 564 F.2d 89 (3rd Cir. 1977), *cert. denied*, 434 U.S. 1047 (1978). The Seventh Circuit also recognized that the provisions of the profit-sharing plan itself were inconsistent with the notion of an ownership interest by plan participants in the actual assets of the funds. (Petition, 12a-15a). Petitioners acknowledge these provisions, but assert that the profit-sharing plan also provided that the trust fund could not be used for any purpose other than for the exclusive benefit of the participants. (Petition, 21). Petitioners, however, have simply ignored the Seventh Circuit's conclusion that the term "participants", as used in the profit-sharing plan, includes participants in the plan both before and after it was amended, and hence, includes all Velsicol employees that, are covered under the defined benefit plan. Petitioners conceded below that the assets of the plan were used for the exclusive benefit of the larger group of participants, but claimed that only those participants in the plan at the date of conversion were entitled to share in the earnings of the trust fund at that date. No rationale is suggested by petitioners as to why such a restrictive reading of the term "participants" would be appropriate, and none exists.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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